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An Empirical Analysis of Japanese Corporate Boards

D. B. P. H. Dissa Bandara[1]

Abstract

This paper examines the nature and the role of Japanese board of directors and thereby reveals the future path of Japanese corporate boards. The changing nature of board of directors has been investigated through 63 companies covering 25 out of 33 officially classified sectors of the Tokyo Stock Exchange and another 15 small and medium scale companies. In addition to the analysis of the overall sample, this study investigates four sub- samples that are constructed on the basis of different patterns of corporate governance. The examination includes a questionnaire survey followed by 10 critical incidents and another 30 telephone interviews as a means of corroborating evidence.

The results give in-depth understanding compared to the previous studies based on the evidence derive through the sub-samples representing different patterns of governance. Leader of the board of directors meeting is basically the president, especially in the companies having a traditional approach to corporate governance. Conversely, the companies which shifted to US committee system the leader of the board of directors meeting is mainly an outside director. A large number of the companies have already started to circulate a formal set of proceedings with a notice at least a week before the next board meeting even in several small and medium scale companies while there are still some companies that do not distribute the documents in advance.

The *keiei-iinkai* or a similar decision making board of directors is still the center for major decisions in small and medium scale companies, and companies having traditional governance system. The major decisions of global companies having either committee system or intermediate system are taken at the board of directors meeting. When attaining a long-term goal is in an uncertainty, disregarding the nature of governance system, Japanese boards try to grasp any failure through their monitoring function. The larger companies having either intermediate or committee system shifted the power of selecting the next president from the existing president to a board committee. About half of the companies have already implemented the outside directors though some of them are not independent in actual terms. Particularly in larger companies having shifted to US committee system, there are independent directors similar to their

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Western counterparts. No matter the system is traditional or US committee, the board of directors and president of Japanese companies have an above average influence on their corporate governance systems. At present the companies are more concern about very specific board reforms such as implementation of performance evaluation and review of compensation. The 'ceremonial nature' of Japanese Corporate Board has been shifting away to some extent and emphasizing more on efficient and effective decision making.

The nature and the role of board of directors of companies shifted to US committee system and intermediate system have been significantly changed. There is a trend of monitoring over execution indicating a tendency of converging towards the Anglo-Saxon model. Conversely, there are several larger companies greatly refuse to accept the new reforms instead they consider improving the system along with the local and global requirements. The small and medium scale companies still prefer the traditional approach which benefits them over half a century. They have taken some measures to improve their traditional system for better governance.

Keywords：Board of Directors, Outside Directors, Executive Directors, Stock Options, Corporate Governance, *keiei-iinkai*

1. Background

Subsequent to the World War Ⅱ, Japan was one of the fastest growing economies in the world. One of the specific features of corporate Japan that commanded special attention was its corporate governance (CG) system based on keiretsu[2] which was exercised frequently by the main bank in the group and cross-shareholdings. In accordance with many empirical studies, this system lead with main bank was one of the fundamental factors contributing to the success of Japanese economy especially from the period-of-high-growth to the period-of-second-oil-crisis (Chan-Lau, A. 2001). This view has been irritated by the collapse of the bubble economy in the early 1990s and the developments through the globalization. Subsequently, various view points were emerged by giving multifaceted views and reasons to the problem. Among the widely known attempts the slashing of interest rates to near zero percent (Nishiyama, C. 1999), substantial government expenditure on public projects (Cortazzi, H. 1999), deficit spending at unprecedented levels (Cortazzi, H. 1999) and several other motivational actions to stimulate the economy including the distribution of shopping coupons.

In addition to uneven and adhoc measures until mid 1990s, the Japanese government has already implemented two main systematic remedial approaches which make drastic changes even in the socio-economic system of Japan. The first one is the introduction of Japanese financial system reforms; "Japanese Big Bang" with the purpose of establishing a 'free, fair and global' financial system launched by Prime Minister Ryutaro Hashimoto on 11th November 1999 (Itoh,

2　long-term relationships among a group of firms

Y. 2003). The scope of Big Bang is very broad including reforms in capital markets, banking, insurance and accounting standards. The next most significant reform effort is the revision of Commercial Law. According to Ministry of Justice (2004) more than one hundred years have passed since the basic civil and commercial laws of Japan were first introduced during the *Meiji* era. Many of those laws were drafted using the laws of various European countries including Germany as models. Even though the Commercial Law has been undergone a number of significant changes when and where necessary, further revision of many essential legal concepts and structures is now required to meet the reality of the modern Japanese society in the 21st century. The revisions to the Commercial Law are numerous and wide ranging but can be categorized in to two main areas such as revisions relating to 'corporate structure & deal mechanics' and revisions relating to 'corporate governance' (Poe, M. and Shimizu, K. 2002). According to Ministry of Justice (2004) the drastic changes in the area of CG included the introduction of US-type CG system with three committees and executive officer system, outside directors (majority of members of each committee should be composed of outside directors), delegation of substantial management authority, abolition of the restriction on the quantity of stock options and transfer of stock options, issuing new classes of shares with rights to appoint and dismiss a specified number of directors or statutory auditors, permission for "e-vote" etc. Along with the above turbulent setup, Japanese corporate boards cannot be avoided from the impact evolved through the socio-economic changes as a whole.

1. 1 Views about Board of Directors,

Today's larger company is found on the capital market with its numerous and varying shareholders. It is rather natural that there is a limited room for shareholders to focus on management supervision at the Annual General Meeting (AGM). Hence there is a fundamental necessity of having an intermediary that is the board of directors (BOD), between company management and shareholders. In the US, which has the most experience in operating a capital market, has come to be representative of the one-tier system, though the board was initially formed as the management body. Currently most of the BOD are from the outside giving a higher level of independence and hence, in practical terms in the US the board performs as the supervisory element of the company management. However in Japan the concept that the BOD is somewhat different from Anglo-Saxon model.

"The debate on corporate governance has focused on the role of boards of directors, because they are the bridge between those to whom the board is accountable and those who are accountable to the board. " (Cadbury, A. 2002)

OECD (1998) shows that the heart of systems of corporate governance is the BOD, as it is "uniquely positioned as the internal corporate mechanism for holding management accountable to shareholders". DeloitteLearning (2004) stresses that the ultimate success or failure of an effective CG process rests with BOD who have an obligation to ensure that their organizations, accountants, audit committees and law firms act in accordance with corporate bylaws, charters, policies and the rules of law. Again OECD (2004) enlighten that the corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

"If the board is not taking the company purposefully into the future, who is? It is because of boards' failure to create tomorrow's company out of today's that so many famous names in British Industry continue to disappear" (Harvey-Jones, J. 1998)

By looking at future path of Japanese corporate governance, (Japan Corporate Governance Committee, 2001) has already formulated principles to separate the supervisory role of BOD from the role of executive managers as follows;

"Board of directors performs the role of management supervision body, which specializes in determining the direction that the executive managers should take, from the point of view of the shareholders, while the executive managers as a management body devoted themselves to carrying out the business of the company."

According to the above views BOD should be the element which performs as the management supervision body of the company; the board should not perform as the element of managing the company. However, Japan Corporate Governance Committee (2001) claims that in Japan, the concept that the BOD is a management body, which remains deeply enriched even today, has its roots in the fact that no BOD system existed in Japan prior to the Second World War, and directors were regarded as being one and the same as the company management. Throughout the evolution of the Japanese board, there was at least one of the three types namely, representative directors, executive directors and employee directors. Therefore the history allowed almost all the directors to play a vital managerial role in Japanese companies even though there were some criticisms mainly from the West.

2. Objectives of the Study

The purpose of the present study is to add some light on the area of corporate boards which is a significant element of the Japanese CG structure. More specifically, this study attempts to identify the nature and the role of BOD and thereby to reveal the reality and to understand the future path of Japanese corporate boards.

3. Review of Literature

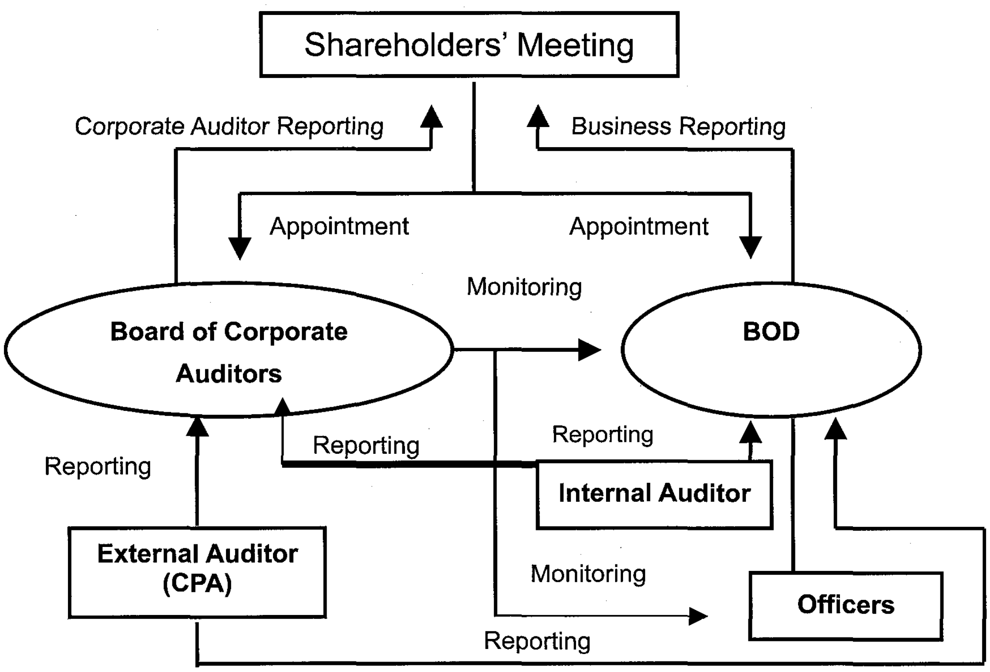
Empirical research on Japanese BOD is very limited. Therefore it is a must to have a careful attention to review many of the available facts about the possible aspects pertaining to Japanese Board. This section presents various literature on Japanese corporate governance system as a whole, Japanese style decision making, role of BOD, ceremonial nature of Japanese boards, *jomu-kai* and its significance with some evidence about the recent changes in order to facilitate proper understanding about the BOD and its role within the system of Japanese CG.

3. 1 Japanese Corporate Governance System and the BOD

As Japan rebuilt its economy in the years following World War Ⅱ, it developed a unique CG structure (Monks, R. A. G. and Minow, N. 2003). This system has two horizontal boards, namely 'BOD' and 'board of corporate auditors'. The traditional Japanese corporate governance system is different from the Unitary Board Model or 'Anglo-Saxon model' and the 'two-tier board model' or the Continental European Model. Though the Japanese model as given in figure 01 has two boards, it is different from the two tier model which is typically more societal-oriented being the basis of corporate governance adopted mainly in Germany, Holland and France. As specified by (Tricker, R. I. 1998; Herrera-Lim, R. M. 2004), Japanese model is a business network model which reflects the cultural relationships seen in the Japanese *keiretsu* network, in which boards tend to be large, predominantly executive and often ritualistic.

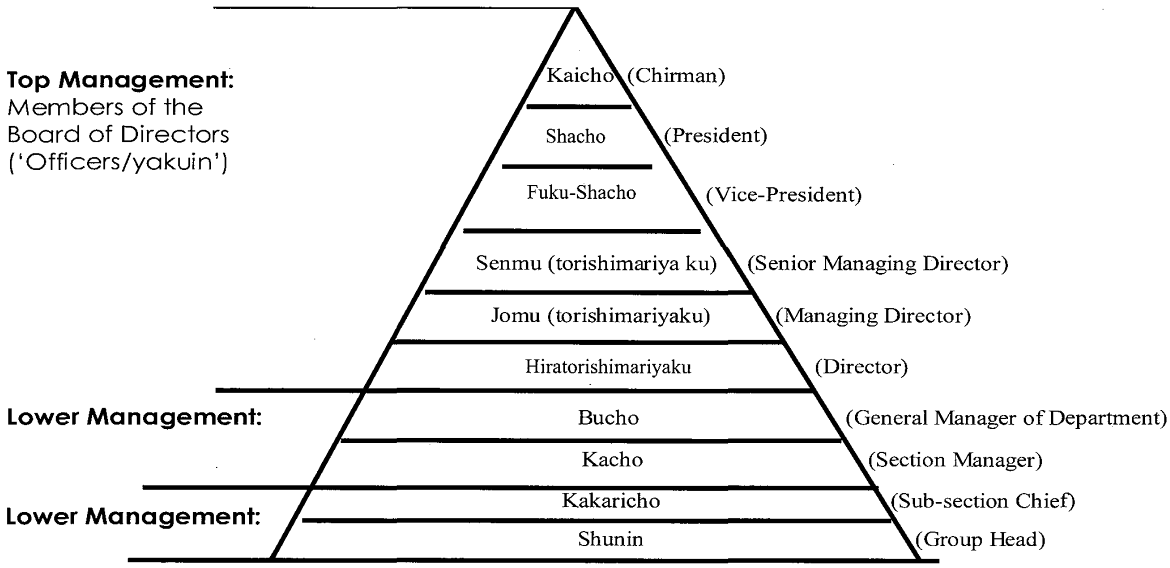
3. 2 Management Hierarchy

The internal organization of the Japanese company is different that of the counterparts of



Source: Dissa Bandara D.B.P.H. (2004) based on Ministry of Justice (2004) & Japan Corporate Auditors Association (2004)

Figure 01 Corporate Governance Mechanism in Japan: Two Board System



Source: Based on Ohtsu Makoto and Imanari Tomio (2002)

Figure 02　Management Hierarchy in the Japanese Company

other countries, especially the levels or the strata (see figure 02) and the way of communicating within the company. Similar to the Western countries, three levels of management can be found in the Japanese company too. As one of the key differences, the top level is much bigger with larger number of BOD with different levels in Japanese company compared to its western counterparts. Generally top level includes *kaicho* (Chairman), *shacho* (President), *fuku-shacho* (Vice President), *senmu torishimari-yaku* (Senior Managing Director), *jomu torishimari-yaku* (Managing Director) and *hira torishimari-yaku* (Director). In some companies *bucho - General* Manager also a member of the BOD.

3. 3 Japanese-style Decision Making and the Top-level

It is commonly known that the decision making in a Japanese organization is quite specific having several unique characteristics owe to Japanese. Management decision making in the Japanese company is often characterized by practices such as *ringi* (proposal submission and deliberation), *nemawashi* (prior consultation/negotiation before meeting), as well as *frequent and long meetings* allegedly unique to Japan. Japanese style management decision making is labeled as *'bottom-up decision making,' 'group decision making,'* and *'consensus decision making,'* (Ohtsu Makoto and Imanari Tomio 2002). One of the major contributions for Japanese style decision making is the Theory Z, participative approach to decision making introduced by William Ouchi in 1981. He explains decision process as given below.

"When a major decision is to be made, a written proposal lays out one 'best' alternative for consideration. The task of writing the proposal goes to the youngest and newest member of the department.... He talks to every one, soliciting their opinions.... In so doing he is seeking a common ground.... Ultimately, a formal proposal is written then circulated from the bottom of the organization .... At each stage, the manager in question signifies his agreement by affixing his seal to the document. At the end of this *ringi* process, the proposal is literally covered with the stamps of approval of sixty to eighty people." (Ouchi William G. 1981)

In contrast, Yoshimura Noboru and Philip Anderson (1997) disagree to the opinion that decision making is bottom-up while agreeing to the *ringi-sho* as a key process of decision making[3]. They state that this particular way of decision making is an illusion that Japanese firms create to motivate workers and to inform regarding the decision and thereby get the support from the workers to the potential decision. Further, in a recent study, Ohtsu Makoto and Imanari Tomio (2002) also find that *ringi* did not perform a key role as a corporate level decision making tool covering company-wide decisions, rather in a range of higher-level meetings (executive meetings or committees) it was well accepted. Instead, both consultative and consensus decision making styles[4] are popular (Vroom, Victor *et al.* 1973) in the top level decision making in Japanese firms.

3. 4 Role of Japanese BOD

The literature on Japanese BOD is very few and the depth of the studies also a significant matter to be concerned. The only available empirical studies on Japanese boards and their roles are also highly influenced by the economics-based interpretations and basically the argument is that the period of rapid industrialization subsequent to the *Meiji* restoration was fundamental in the way that Japanese boards developed. According to Fruin (1992) the former *samurai* who originally controlled commerce and the merchants suddenly understood that they did not have adequate knowledge and skills to run the new businesses evolved through rapid industrialization and growth. As evidenced by Yonekawa and Yoshihara (1987), former controllers of commerce were willing to rely on the fresh knowledge and experience of new graduates from the university and at times experienced business handlers from the west in order to run the organizations initiated by them. Hence there was a bloom of taking decisions by the professionals like supervisors, bookkeepers in place of technical owners.

In a similar way, even though BOD was presumed to be a body of representatives of shareholders as per the Japanese Commercial Law it became a representative organ of employee interest rather than a representative of shareholder interest. This nature was rapidly developed to appoint members to the board exclusively from the layers of employees and the board was

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3 *Ringi-sho (hatsuan-sho/shinsei-sho/ukagai-sho/kessai-sho/ketteishinsei-sho) is* a circular intended to get approval of a decision which starts from the lowest level employee affected by the proposal and move upward.

4 ***Consultative style*** (manager makes the decision after consulting the subordinates). Since faster decisions are required in trading and services industries the consultative style which is less time taking is used. **Consensus style** (manager lets subordinates to emerge with a group decision which will be accepted by him). This style is usually used by manufacturing and transportation industries.

not any more towards the interests of shareholders instead it was transforming to a center of safeguarding the employee rights and interests. The tendency was further confirmed by Yui (1984), mentioning that the extraordinary and persistent pace of economic and technological developments in Japan has further concentrated power into the hands of top executives.

Accordingly, as a whole, it seems that there is a common belief that the board is a representative body of employee instead of shareholders. Is it reasonable to generalize the concentration of Japanese board, which is having number of levels of directors as shown in Figure 02 in such a manner? However, in relation to a recent finding, (Itoh, H. and Teruyama, H. 1998), opening the black box of top management in Japan, explain the different attitudes and behaviors between the different layers of directors within the board. Along with their findings, senior directors are more concern on investors and share prices while non-titled directors have a propensity to focus highly on employees, specifically those who are in the operational areas which they represent. In large companies, statutory auditor also tend to be focused on the welfare of investors and employees as well, though in smaller firms auditors have a tendency to concern with loyalty to and cooperation with senior directors. External directors tend to focus on stock prices and credibility of the company on the side of shareholders and banks, and are far away from concerning about the employees.

As the leadership engine of the company, the board's function is to set the company's strategic direction; vision, mission and objectives and to ensure that they are achieved. This is what Sir John Harvey-Jones meant by his expression quoted on the top of this paper. Corporate governance guideline, policy or code provide the necessary framework that will back the board to meet the expectations or the rational of the company, however, it is up to the leadership function of the board to drive towards the overall prosperity. According to Carver John (2002) author of Policy Governance Model, direction is the job of the board to set the ends, that is to say, to define what the company is in business for. There are apparently dramatic board changes including the area of board's leadership and direction role under way in Japan generally. In a very recent study Learmount (2002) found no evidence of operational decision-making being decentralized, or the powers of the board being revised in any significant way. Further BOD as a group was described as little more than a ceremonial body, with no real authority of its own. More specifically, the board did not have any input into the generation or revision of major decisions as such decisions are taken by a powerful small group of senior directors (most of the time referred to as *jomu-kai*) in a separate meeting instead of the board meeting. The situation is more critical when the company is a family or a private business. As quoted by Learmount (2002) from his interview findings *'My husband and I talk about the strategy and policies we are thinking about in the long and medium-term, and the board will decide whether they should say something or agree or whatever...'*. Hence, there is a question whether the leadership and direction role is played by all the members of the board as a whole or a restricted group of senior directors and as a result, the strategic direction of the company is not determined by the contribution of all the members of the board.

As far as the views of CalPERS (2004); and OECD (1996) on role and the practices of Japanese BOD are concerned, Japan's boards need to improve their accountability to shareholders and a most feasible way of achieving this is to increase the number of independent directors. Well-known institutional shareholders such as CalPERS have established specific guidelines relating to Japanese boards within their principles for good governance in Japan as follows:
"Japanese Corporate Boards Should Consider the Interests of, and Strive for Accountability Toward, All Shareholders...Corporate Boards Should Include Directors Who are Truly Independent from the Corporation and its Affiliates...Best Governance Practices in Japan Should Include Elements that Strengthen Management Accountability to Corporate Owners through the Director-Shareholder Relationship." (CalPERS 2004)

In view of that, when a board is composed mainly of insiders, as is typically the case in Japan; it must take particular concern to avoid any conflict of interest and to focus on the interests of minority shareholders. The board's preliminary attention should be on safeguarding the interests of shareholders and providing them with the highest possible long-term returns on their investment ensuring that a board of director's major concern is to represent all of a company's shareholders. During the last two decades, it is observed that there were a considerable number of external directors being appointed. OECD (1996) evidences that approximately 25% of Japanese company directors do come from outside, as given in Table 01.

However, it is a puzzling issue whether the Japan's external directors are independent in real terms because, most of these external directors come from related organizations such as other

Table 01 Origins of Listed Japanese Company Directors

%

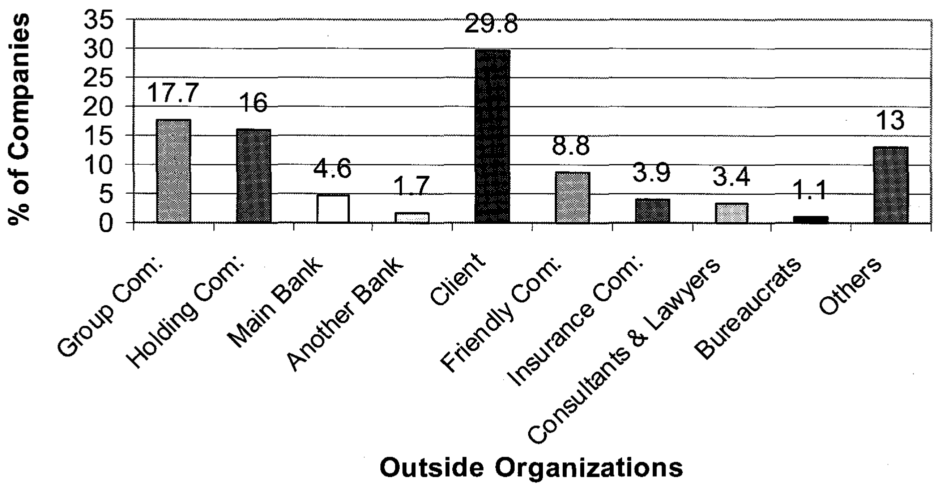
	1984	1989	1994	Average 1984-94
Company Directors				
Internal	74.2	75.6	73.1	75.1
External	25.8	24.4	26.9	24.9
Other Companies	17.1	16.3	18.3	16.7
Banks	5.4	5.4	5.8	5.4
Government	3.3	2.7	2.8	2.8
Senior Executives				
Internal		60	66.1	
External		40	33. 9	
Other Companies		29.7	22.7	
Banks	7.1	6.3	6.8	6.8
Government	4.7	4.0	4.4	4.5

Source: OECD (1996)

companies or banks. According to Dissa Bandara (2004), a noteworthy observation is that little below 40% of the outside directors (see Figure 03) are coming either from the company's parent company, group company or main bank generating a significant issue relating to the independence of outside directors. Directors from client or trading companies means that they are from the keiretsu companies which again a destructive factor of their independence showing an aspect of the traditional governance system.

Therefore, it is quite straightforward to understand that Japan's external directors unable to exercise independent opinion or represent the shareholder interest. This may be the reason for CalPERS (2004) to suggest that the Japanese boards should include independent directors to ensure that all shareholders are well represented, particularly in cases where executive directors may have conflicts of interest. Independent directors provide additional assurances to outside investors that a company is run in accordance with the law and with sound accounting and auditing principles. To the extent that independent directors cause a corporation to focus less on the interests of insiders and more on shareholder returns.

Viner (1993) in his viewpoint argues that the malfunctioning of accountability is considerably due to the inadequate independent supervision. The fundamental authority of the BOD of Japanese companies has traditionally lain in the board's power to prescribe the business practices to be executed and to monitor the company's directors and corporate executives in the execution of their duties. Specifically, the BOD comprised of at least three board members elected at the general meeting has the authority and the obligation to determine corporate policy regarding business execution and to elect a representative director, who is authorized to execute these decisions, while also monitoring the representative director and the executive directors in



Source: Dissa Bandara D. B. P. H. (2004) based on data from the Policy Research Institute of Ministry of Economy & Financial Services (2003)

Figure 03　Where Do Outside Directors Come From?

the performance of their duties. In the West the accountability of the board is guaranteed due to the considerable number of independent directors and their dedicated work. Viner specifically mentions that *"the ability of the president to collude with the directors- who are themselves senior managers appointed by him- in order to conceal serious irregularities, is particularly strong in Japan where the absence of any outside supervision provides a cloak for every dragger"*. Accordingly, the president becomes the most powerful figure and has the power to appoint or and remove directors in practice as he wish. Hence, the other directors or and officers become unnecessarily obedient to the president.

By looking at the Japanese boards and the contents, an outsider may be able to presume such a view and might feel the hypothesis is logical. However, Viner's view is some what ambiguous, may be due to some limitations of his inquiry in to the practice of Japanese boards. Though he criticizes the tradition of appointing the directors to the Japanese board by the president, the real world situation, in general, in the West except countries like Germany and many other Asian countries, the appointment is done by based on the invitation of the president or CEO. In addition, when compared to WorldCom and Enron cases in the US, it is rear such material irregularities or misstatements in the Japanese setup. As mentioned by OECD (1996), compared to the UK and US, it is easier for shareholders to nominate candidates to the Japanese board and to dismiss them. As an example, according to the article 257 of Commercial Law, a motion to dismiss a director can be filed by a shareholder controlling 3% of the issued shares. Further the cost of suing the directors also remarkably reduced by the amendment to the Commercial Law in 1993[5]. Except for the over emphasized statement of Viner, the essence of his argument is relating to accountability of Japanese BOD. On average, in the Japanese setup most directors had worked for the company as employees or managers in their career ladder. Therefore the directors are officers as well as BOD. Hence there is no proper monitoring over execution since there is no demarcation except the labels 'officer' and 'BOD'.

Relating to the above but not adhering to the same, another argument is that the conventional board members lack an overall understanding on corporate management. As Hiroyuki, (2003) evidences, although these directors attend board meetings as representatives of their specific departments, they lack a company-wide perspective on management. In contrast with the US system, the individual director of the board is a functional head of the organization. Therefore naturally each board member specializes only for his or her own specific field rather than having an organization-wide management perception. Furthermore, with all members of the board in positions subordinate to the president as mentioned above and these boards of directors were criticized for not fulfilling their obligation to monitor the president. Until the

5 This revision to the commercial law article 267 (5) reduced the stamp duty (8200 yen) by introducing the calculation based on an estimated stable fine (950,000 yen), even though the actual figures may be significantly varied. This is a considerable reduction of cost of suing a director by a shareholder compared to the amount to be incurred for such action before 1993.

'corporate executive officer system' introduced by the revised Corporate Law in 2002, there was no incentive to separate monitoring from execution in Japanese firms. However, may be due to the initial stage, it is reported that there is some resistance to accept the new corporate executive officer system too.

3. 5 Ceremonial Nature of Japanese Boards

Thus far, the above literature is helpful to guess and to evolve an idea about the nature of Japanese board meeting. In general, traditional board meetings as the superior situate of governance are also formal and very short. According to Cooke and Sawa (1998) over 80% of the companies relied that their board meetings take two hours or less on average. More often than not the board meeting is considered as a formality, as it is compulsory to be held as per the provisions of the Commercial Law[6]. While it is a legal formality, it is again a kind of festivity among Japanese corporate citizens. As some pin point the board meeting is a place where the policies and decisions are ratified and disseminated throughout the company. These decisions are made somewhere else: mainly in a different place like *jomu-kai* (senior management meeting or equivalent) indicating that the decisions are officially seconded by the board with no real authority to fine tuning the original decision. Another aspect is that it is a meeting for heads of divisions to report the operational matters, acknowledge the entire entity and hence it is a representative meeting of the whole company with large number of members.

The nature of this formal corporate communication role of the Japanese board may be mainly due to the managerial decision making system in the Japanese companies. As discussed earlier, Theory Z of Ouchi (1981), participative approach to decision making is a distinctive feature of Japanese organizations and the *ringi* process communicates the new proposal and obtains the consent from the bottom to the top of the organization. Since the substance has already been adequately discussed (*nemawashi*[7]) for a long time and agreed in all other levels, the BOD doesn't need much more time for approval. However it is heard that the situation is improving gradually by taking more time on corporate issues with more concern as many expected with the Bib Bang deregulation attempts and many other related regulatory measures now.

Therefore, *"when the proposals are on the [board-room] table they are really really agreed... Board meetings are really very ceremonial"* (quoted in Learmount, 2002, p. 127). Then, we have to find the answer for the question 'who runs the large Japanese companies with real authority?' Among many views on this issue, DeMente (2004) make a more clear and compact state-

6 According to section 260 (4) of Commercial Law, BOD should conduct formal meetings once in three months.

7 laying of ground work with prior consultation before a decision

ment that in Japanese companies, the function of the BOD is mostly ceremonial, and the title of "director" is primarily "social." The board that really runs the large Japanese company -- if one does -- is the JOMU-KAI or "Managing Directors Board." In coincide with the above Monks (1994) also evidence that the *kaisha*'s [corporation's] board is an arm of executive management and that it is the *jomu-kai* [board of top executives] that effectively controls the company. The *torishimariyaku-kai* [BOD], exists in little more than name only.

3. 6 *Jomu-kai* and its Significance

As a real decision making body in other words a board committee with authority of the Japanese company, *jomu-kai* (Senior Management Committee/Managing Director Meeting) is played a key role. The following are some of the fundamental characteristics which are derived from the comprehensive research conducted by Ohtsu Makoto and Imanari Tomio (2002) regarding the *jomu-kai.*

- ...major decisions are taken by *jomu-kai* consisting of few members compared to the entire board members...
- ...participants freely express their views on agenda items. When it comes to decision making no vote is taken; rather, consensus style is adopted. In reality the president's voice carries heavy weight...
- ...there is no representatives from the parent company at *jomu-kai* and no attempt by the parent company to interfere with the subsidiary' s business operations...
- ...*jomu-kai* meetings are held once a month primarily for information exchange...
- ...topics are limited to key company issues...

Accordingly, *jomu-kai* can be considered as the highest level decision making authority which determine the future direction of the Japanese company. To be brief, Mizuo Junichi (2004) states that Japanese boards are often oversized. Important decisions are made by a limited number of managing directors, who collectively form a *jomu-kai* or a *keiei-iinnkai* (managing directors committee). Power is concentrated in the *shacho*, who also assumes the role of representative director[8]. The *shacho* calls the shots on strategy, budget and nomination of other board members and officers.

3. 7 Some of the Significant Changes and Recent Trends

The ongoing corporate governance reforms, both voluntary and legal able to take the eye of domestic and foreign attention as one of the means to revitalize Japanese company. The following are some of the latest empirical evidence with regard to Japanese BOD.

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8 Section 261 (1) of Japan Commercial Law requires one or more representative directors to be elected by the board to sign official documents on behalf of the company.

3. 7. 1 *Outside Directors*

The outside director system is becoming more popular even though the rate of increase is lower than the executive officer system. According to Policy Research Institute of Ministry of Economy & Financial Services (2003), 35. 8% of the firms expressed that they have already introduced outside director system. Compared to their 1999 survey, as shown in the Table 02, the growth rate of companies adopted this system is 18. 94%, however there was no substantial development in the introduction compared to the executive officer system. Lack of talented people available for the post of outside director is often pointed out as the reason for such underdevelopment.

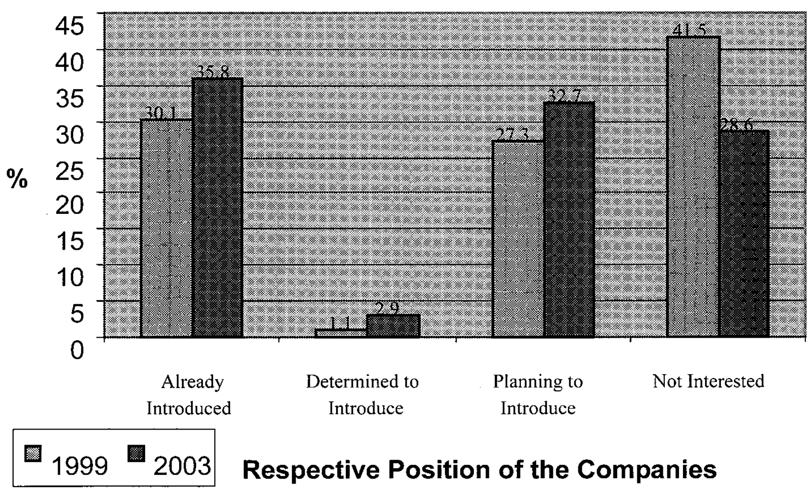
On the other hand, the Figure 04 shows the number of companies that do not have intention to introduce the system has fallen by about 31% compared to 1999 survey. However, still 28. 6% of the companies compelled to refuse the introduction of outside director system due to several reasons. Table 03 derived from Komiyama and Masaoka (2002), distinctively mentions the prac-

Table 02 Implementation Outside Director System

As a % of total number of sample

Stage of Transition	1999 (1138 Companies)	2003 (863 Companies)	% Change
Already Introduced	30.10	35.80	18.94
Determined to Introduce	01.10	02.90	163.64
Planning to Introduce	27.30	32.70	19.78
Not Interested	41.50	28.60	(30.92)

Source: Policy Research Institute of Ministry of Economy & Financial Services (2003)
Additional Note: More than 50% of major corporations (capitalized at 30 billion yen or more) replied that they have already introduced the outside director system



Source: Policy Research Institute of Ministry of Economy & Financial Services (2003)

Figure 04 Implementation of Outside Directors tical problems and their impact for non-introducing outside director system. As per the findings, majority of firms opposes it due to lack of appropriate outside personnel. Some companies understood the new concept as a similar one to the corporate auditors and therefore they would like to proceed with outside corporate auditors. Traditional boards were generally comprised of members who had spent half their lives with company as an employee and they were part of the corporate family. It was therefore assumed that these board members would be familiar with the company's business practices and share in the corporate culture and history of the firm. The central criticism against the outside director system is based on uncertainty that not having been a member of the corporate family (*ie* concept), these board members would not be capable enough to analyze the company's business practices in order to reach an optimal decision. However, traditional boards of directors comprised of senior employees come up with their own set of problems. Unspoken rules exist in the form of corporate and industrial customs, and the fact is that decisions formed in line with this implicit understanding have led to charges for outsiders of lack of transparency. This closed nature of corporate culture had been the key factor behind some scandals that have revealed few years ago. Furthermore, experience has reported some companies to believe that the system of outside directors is impractical. Those who have performed as outside directors in companies, being academics or leaders in other industries have often noticed themselves out of their depth at board meetings, unable to contribute effectively and lacking adequate knowledge to detect proper flaws for companies' performance.

The contemporary board nature and structure are changing away from the traditional manner. Conventional boards were comprised of members who were internally promoted based on seniority or rank and it was hardly found monitoring over execution as the conventional board members acted both the roles together. Now, the boards are becoming greatly diversified ensuring proper segregation between 'execution' (with the implementation of the executive officer system) and 'monitoring' entering into another era of better governance environment.

Table 03 Reasons for not Appointing Outside Directors

Reason	Percentage
No appropriate Candidates	37. 5
Satisfied with advice by outside Statutory Auditor	30. 9
Ensuring outside opinions through different methods	30. 7
Doubts about system functionality	28. 2
Extra efforts required due to lack of business knowledge	18. 6
Other	6. 3
Planning such appointments in the future	3. 7

Source: Komiyama, M. and Masaoka, Y. (2002)

3. 7. 2 *Executive Officers*

The executive officer system is becoming more popular at a greater increasing rate due to the recent reforms. According to table 07, 33% of the firms whispered they have introduced an executive officer system. Compared to the 1999 survey of Policy Research Institute of Ministry of Economy and Financial services conducted four years ago, the growth rate of companies adopted this system is 157.81%.

As far as the major companies capitalized at ￥30 billion or more are concerned, more than 50% of them revealed that they have introduced such executive systems. Compared to the features of the Japanese corporate boards, which in the past was comprised of executives who were promoted through the ranks or seniority and lacked separation between execution and monitoring, have remarkably diversified.

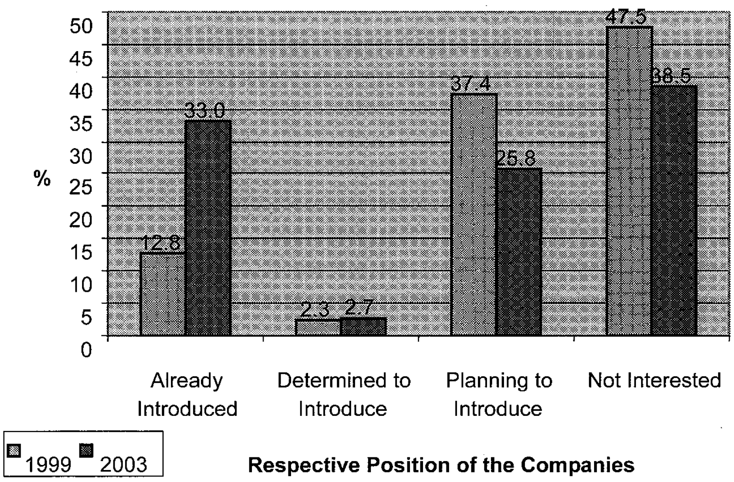
As shown in Figure 05, the percentage of companies that do not plan to introduce the system has dropped a little compared to 1999. However, still 38.5% of the companies compelled to refuse

Table 04　Implementation of Executive Officer System

As a % of total number of sample

Stage of Transition	1999 (1145 Companies)	2003 (846 Companies)	% Change
Already Introduced	12.8	33.0	157.81
Determined to Introduce	2.3	2.7	17.39
Planning to Introduce	37.4	25.8	(31.02)
Not Interested	47.5	38.5	(18.95)

Source: Based on Policy Research Institute of Ministry of Economy & Financial Services (2003)



Source: Based on Policy Research Institute of Ministry of Economy & Financial Services (2003)

Figure 05　Implementation of Executive Officer System

Table 05 Problems in Introducing Executive Officer System and Reasons for Non-Introduction

Question	Problems with Introduction %	Reasons for Non-Introduction %
Resistance from Directors	16.4	02.9
Not yet taken root in the industry	16.4	18.3
Unclear definition of legal status	72.7	36.6
Unclear division of role	40.0	33.5
As many executive officers concurrently serve as directors	18.2	18.1
Cannot reach agreement to reduce the number of directors	20.0	09.2
Adding unnecessary system	14.5	10.1
No clear authority to appoint an executive officer	12.7	4.6
Increase in costs due to executive officers	7.3	10.0
Inconvenience in external negotiations	5.5	3.4
Doubts as to the role of executive officer	—	24.1
No problem with current situation	—	12.2
Other	5.5	18.0

Source: Komiyama, M. and Masaoka, Y. (2002a)

the introduction of executive officer system due to several problems and /or reasons. Table 05 derived from (Komiyama, M. and Masaoka, Y. 2002d), distinctively mentions the practical problems and their impact for non-introducing executive officer system in Japanese companies. In the midst of those, unclear definition of legal status (36.6%), unclear division of role between directors and executive officers (33.5%) and doubts as to the role of executive officer (24.1%) are major problems and reasons for non-introduction of executive officer system. The first one will be solved with the familiarization of amendments to the commercial code with effect from 2003 April. In practical point of view second and the third reasons are more important as they symbolize the uncertainty about the role of an executive officer creating a barrier to its introduction. This situation probably will fade away with the time when companies gradually move towards the system by following the pioneers.

3. 7. 3 *Board Size*

One another key criticism against the Japanese board is that the dealing with unmanageable number of members in the boards in most of Japanese companies. For example, (Hiroyuki, Y. 2003a) found that the number of board members of large companies (capital over 500million yen) about 60% had more than 30 board members and 20% had board members exceeding 40 members. For example,

"There are still a large number of companies with 30-40 board members or even more and that the majority of board members are also employees of the company"

(Hiroyuki, 2003) Executive Director & Chief Operating Officer at the Japan Association of Corporate Directors.

A large number of members is really a bottleneck which slowdowns the efficiency of corporate decision-making. In compliance with the economic expectation, few global level businesses such as Sony Corporation. , and Hoya Corporation. , has already reduced their size of boards voluntarily and several other companies have already started or planned for such downsizing their boards showing some tendency of moving towards the US-style governance model.

3. 7. 4 *Stock Options*

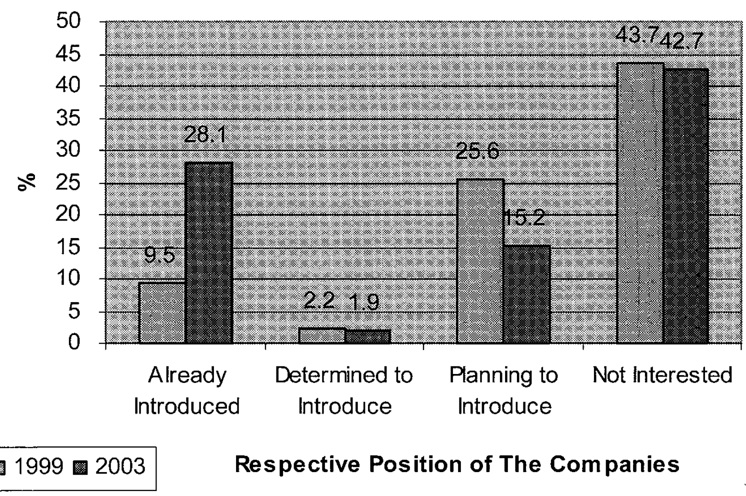
Utilization of Stock option system has also considerably improved after recent amendments to the commercial law. According to Table 06, (Policy Research Institute of Ministry of Economy & Financial Services 2003) evidences that 28.1% of the companies successfully adopted stock option by the year 2003, compared to 1999, it is a 196% increase.

Table 06　Implementation Stock Options

As a % of total number of sample

Stage of Transition	1999 (1209 Companies)	2003 (864 Companies)	% Change
Already Introduced	9.5	28.1	195.8
Determined to Introduce	2.2	1.9	(13.6)
Planning to Introduce	25.6	15.2	(40.6)
Not Interested	43.7	42.7	(2.3)

Source: Created by author based on Policy Research Institute of Ministry of Finance (2003)



Source: Created by author based on Policy Research Institute of Ministry of Economy & Financial Services (2003)

Figure 06　Implementation of Stock Options

As indicated in Figure 06, 17.1% of the companies will introduce the system very soon. However, the ratio of the companies resisting to introduce the system is still little higher than 40%.

On average, there is a large criticism, because the boards are weak and lack expertise, executives have the power to influence their own compensation. They use their power to extract money from the company beyond what is needed to motivate them. Some times it is reported that options can be awarded for general market or industry effects rather than above average performance.

4. Methodology

For the purpose of doing the research 120 companies were chosen at random based on the companies listed on the first section of the Tokyo Stock Exchange (TSE). Having a response rate of 52.5%, 63 companies had responded covering 25 out of 33 officially classified sectors of the TSE (Tokyo Stock Exchange 2004). In addition another 15 small and medium scale companies (SMCs) were also selected to the sample. When selecting a company, a reasonable care had been exercised to include the companies with respondents with a considerable understanding about the keywords such as CG, IR activities, role of BOD, disclosure requirements and annual reporting. Table 07 shows the outcome of the awareness test on the keywords which were considered as a must to continue a meaningful discussion on corporate governance with the representatives of the respective companies. The fulfillment of selecting criteria is specifically given in figure 07.

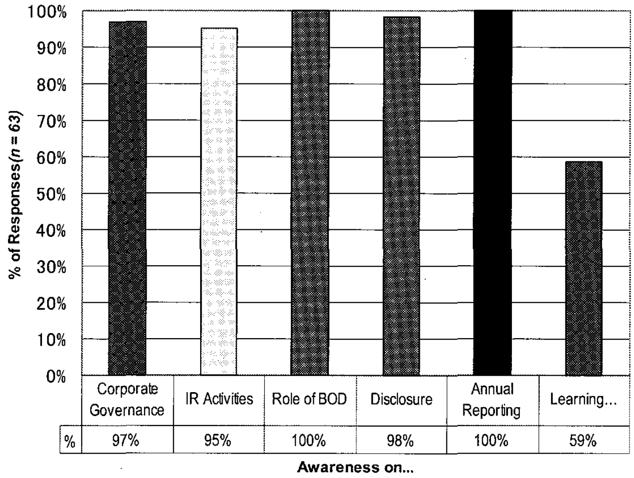
The respondents include popular global companies, top raking domestic companies, medium and small scale companies. The time period covered by the study is 5 years from 1999 to 2004

Table 07 Outcome of the Awareness Test

Awareness On…	No of Companies	%
1. Corporate Governance	61	97%
2. IR Activities	60	95%
3. Role of BOD	63	100%
4. Disclosure Requirements	62	98%
5. Annual Reporting	63	100%
* Learning…[9]	37	59%

Source : Survey Conducted by the author in 2004

9 Respondents' feedback declaring that they have learned at least something from this study



Source : Survey Conducted by the author in 2004

Figure 07　Some Selecting Criteria

giving special reference to the corporate governance situation prevailing at the financial year 2003/2004. A variety of data was collected including governance related data such as frequency and timing of board meetings, circulation of proceedings, way of decision making, implementation of new systems, performance evaluation of boards, future actions to be taken for a stronger board etc. and some financial data. There were several data collection methods adopted with a view to obtain a more comprehensive data set considering the limitations of obtaining such corporate data. Firstly, a questionnaire survey was conducted in May and June 2004 distributing the survey sheets through postal mail, e-mail and facsimile. After reviewing the responses, 10 companies were selected representing all the kinds of companies for adopting critical incident technique suggested by (Chell, E. 1998) using both 'front door approach' and 'back door approach'. Further, telephone interviews were conducted in 30 companies for further clarifications. In addition, many other secondary sources such as press releases, homepage disclosures, annual reports, IR reports, management reports, corporate plans etc. were used as supplementary data.

The data were analyzed by using both qualitative and quantitative techniques. Since there can be several corporate governance systems as a result of the recent reform efforts, the companies in the sample were categorized mainly into four test categories for the purpose of discussing the results of the critical incidents as follows.

- Small and medium scale companies (basically having a traditional governance system)
- Larger Companies having intermediate governance system
- Larger Companies having traditional governance system
- Larger Companies having US committee system

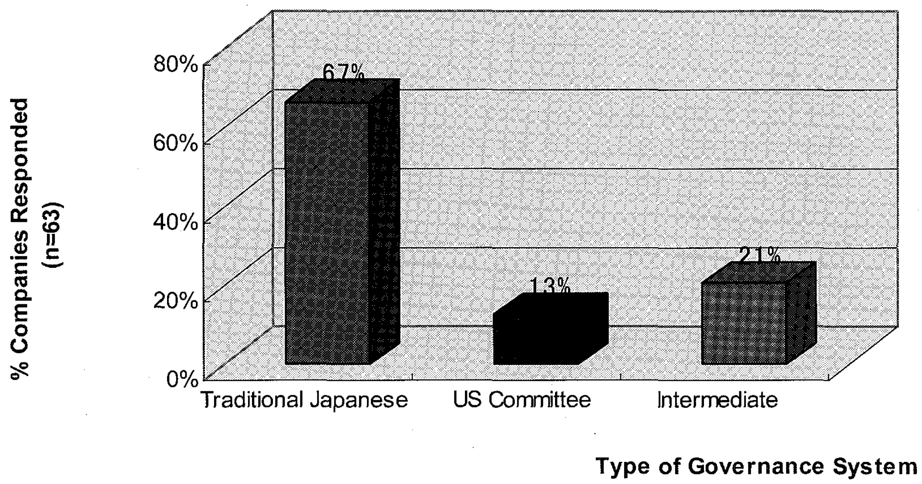
4. 1　Corporate Governance Characteristics of Responded Companies

As mentioned above, various kinds of companies are included in the sample. Table 08 explains

Table 08 Existing Corporate Governance Systems

Corporate Governance System	No. of Companies Responded	%
1. Traditional Japanese System	42	67%
2. The US Committee System	8	13%
3. Intermediate System	13	21%
Total	63	100%

Source: Survey conducted by the author in 2004



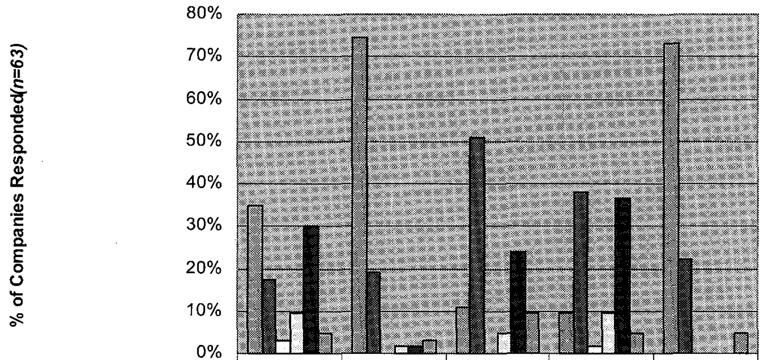
Source: Survey conducted by the author in 2004

Figure 08 Corporate Governance System of Respondents

the existing corporate governance systems of the companies responded.

According to Figure 08, majority (67%) of the respondents are willing to label their CG system as 'Traditional Japanese System'. Only 8 companies (13%) has shifted to the newly introduced 'committee system' suggested by the amendments to the Commercial Law in 2002 and the rest (21%) wishes to label their system as 'intermediate system'.

Though it is too early to evaluate the recent reform efforts, it is clear that there is a considerable change occurring within the corporate governance setup of Japanese companies. Figure 09 gives evidence about a number of sub-systems introduced during the last few years. Among the newly implemented systems, outside auditor system is not completely a new experience for Japanese companies as it was a legal requirement from the first half of 1990s. The outside director system was also in practice in some of the companies from early 1990s as a voluntary reform tool. However during the last 5 years the implementation of various systems by the respondents had been accelerated at an increasing rate.



Status	1. Outside Director	2. Outside Auditor	3. Executive Officer	4. Stock Option	5. IR Activities
More than 5 years ago	35%	75%	11%	10%	73%
During the last 5 years	17%	19%	51%	38%	22%
From now onwards	3%	0%	0%	2%	0%
Not interested	10%	2%	5%	10%	0%
Not decided yet	30%	2%	24%	37%	0%
No Response	5%	3%	10%	5%	5%

Source: Survey conducted by the author in 2004

Figure 09　Important Sub-Systems Introduced During the Last 5 Years

5. Empirical Results

As one of the latest surveys, this study found important and interesting empirical evidence covering many aspects of Japanese corporate boards. The following analysis of results reveals more about frequency and timing of board meetings, circulation of proceedings, way of decision making, implementation of new systems, performance evaluation of boards, future actions to be taken for a stronger board and so on.

5. 1　Leader of the BOD' Meeting

One of the key areas of the study is to identify the nature of board meeting and the leader of the BOD meeting. As per the Table 09, in 44% of the companies, chairman becomes the head of the BOD meeting. This is a favorable trend growing within the Japanese companies indicating a substantial relief from the pressure of execution on monitoring. However, as shown in Figure 10, still in 48% of the companies president becomes the head of the BOD meeting while acting as the CEO of the entity. This shows that about a half of Japanese companies has still lack of separation between monitoring and execution or in other words there is a considerable influence from the president on the board function. Only 4 companies of the sample having either US committee system or intermediate system are using a different way and the head of the BOD meeting is an outside director indicating more independent leadership for proper monitoring.

Table 09

Who is the leader of the BOD' meeting?	No of Responded Companies	% of Responded Companies
1. President	30	48%
2. Chairman	28	44%
3. Others	4	6%
4. No response	1	2%

Source: Survey conducted by the author in 2004

In coincide with the above findings, the critical studies found more specific evidence about the head of the BOD meeting. The smaller companies addict to the traditional system and the president plays a one man show. As a result he becomes the head of the BOD meeting too. This nature is mainly due to less number of directors/managers, lack of leadership ability with higher educational setting and lack of resources. These things concentrate everything in the hands of the person who has been appointed as the president. One president of a smaller company spoke;

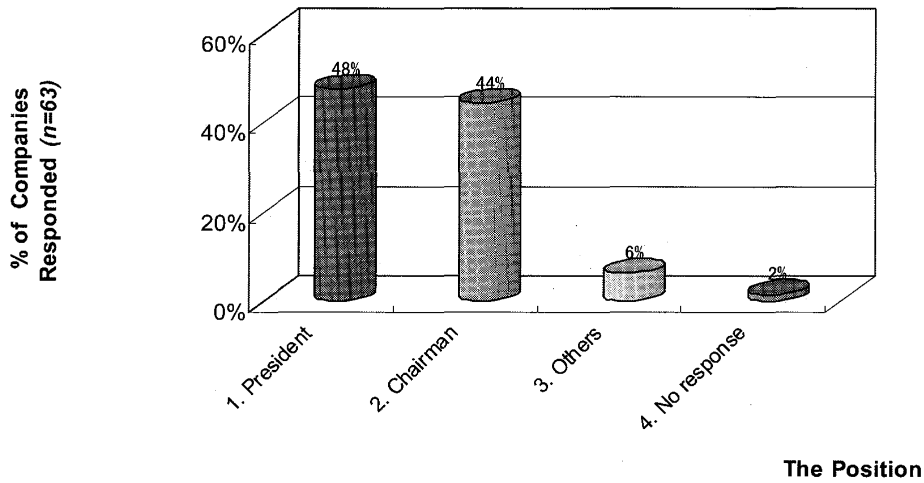
"Ours is little bigger than a sakanayasan (fish stall). So we have limited resources, market and managers. All directors have climbed through the seniority system. Though I like, there is no person to take responsibility other than gambaru (indicates working hard for the given target) with employees. Their contribution to long-term decisions is very unsatisfactory. Therefore, I am like the father of Japanese ie."

The evidence grasped from several other SMCs also repeatedly confirmed the above tendency using similar words. The dominance by the president in every function is not an automatic function rather it evolves through above circumstances. Then the president becomes the father of the house engaging with any activity for the benefit of all family members. As the company is also a social unit it automatically utilizes the cultural values evolved through years and years.

As far as the larger companies having traditional governance system are concerned, they also use a similar system to above giving similar reasons except the limited resources including human resource. It seems that every one in the family (here the company) respect the father (here the president) and expect everything from him. One senior managing director emphasized;

"Though ..... (name of company) is seeking for profits (for all), this operates like a family. This is a real Japanese family. The status for father, mother and children is determined. Therefore, father is powerful to make any decision. It is not bad. As the environment is changing, recently all other members help him to make better decisions to face the competition."

The *ie* concept is a deeply routed social value even inside a company. Therefore it is an inherent feature of governance in the Japanese company, especially having a traditional approach to CG. Conversely, the companies which converted their governance system to US committee system do not seem to be adhered to such traditional matters; instead they pursue the rules and



Source: Survey conducted by the author in 2004

Figure 10 Who is the Head of the Board of Directors' Meeting?

norms which followed by the system. Therefore the leader of the BOD' meeting is mainly an outside director like in the US current practice.

5. 2 Timing of Circulating the Proceedings

As a basis for a proper board meeting the notice, agenda and the proceedings of the previous meeting are a must. On average, Japanese companies tend to use the term 'proceedings' or in other words all the above materials are sent together for inviting to the next meeting. According to Table 10, 38% of the companies circulate the proceedings one or two weeks before the BOD meeting allowing the members to prepare for the meeting adequately. On the other hand 44% of the companies do not have a specific time period to circulate the proceedings. This means that there is an uncertainty about giving a sufficient time for preparation for the board meeting in little less than a half of the companies. As given in Figure 11, three companies (5%) distribute the materials just one day before the board meeting laying the directors in a harder situation to get prepared overnight for the meeting.

Table 10

When do You Circulate the Proceedings of the Board Meeting?	No of Responded Companies	%
1. One or two week before the next boards meeting	24	38%
2. The day before the next board meeting	3	5%
3. At the time of Board meeting itself	2	3%
4. No specific time period	28	44%
5. Others	2	3%
6. No response	4	6%
Total	63	100%

Source: Survey conducted by the author in 2004

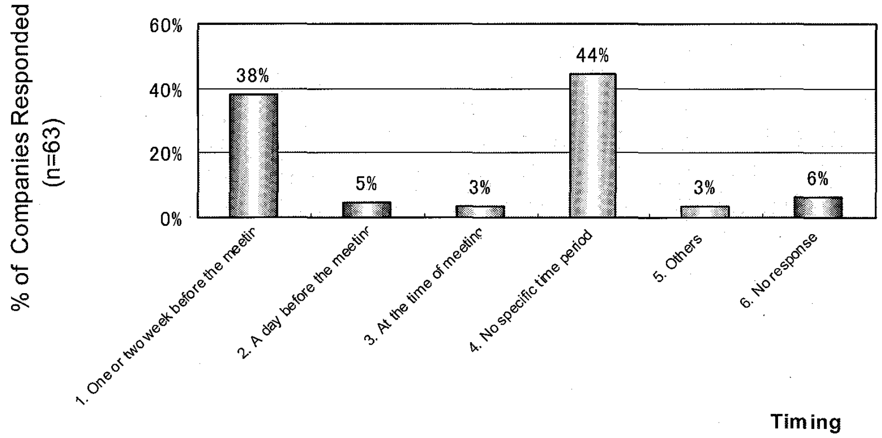
As far as the critical incidents are concerned, almost all the participants declared that they distribute at least a brief notice. Sometimes 'others (*sonotha*)' contains important issues compared to listed items in the notice or agenda. Timing of distributing the materials is not certain; it ranges from one or two days to one or two weeks. Intermittently, there are some instances when there is no proper notice in advance. e. g. emergency issues to be attended. One senior managing director of a medium scale company contributed;

"we get a notice from the office few days before the meeting (some times 1 week, but mainly few days before and sometimes suddenly when there are hot issues with CEO), occasionally with reports. For me, the most important things are the matters discussed under 'sonotha' though they are not printed. Of course, points listed on the notice also important..."

In larger companies, whatever the governance system is; a formal notice with proceedings is sent at least one weak before the meeting and as a minimum, one meeting is held once a month. The number of meeting for a month is not restricted or predetermined; when and where necessary additional meetings are called to address the important matters immediately. A director of a company newly shifted to intermediate governance structure added;

"Under the new setting we get the materials (defined in the manual) around 1^{st} as we have the meeting around 10^{th} every month. Additional meetings are held when required. Now the arrangements are better for the meeting... (silence) ...may be due to outside directors..."

Companies are gradually entering to circulate a more formal set of proceedings with a notice at least a week before the next meeting even in several medium and small scale companies. However there are still a considerable amount of companies that do not distribute the documents allowing a specific time period before the meeting. Newly restructured companies toward US committee system or intermediate system attempt to provide a comprehensive set of materials at least one week before the meeting.



Source: Survey conducted by the author in 2004

Figure 11 Timing of Circulating the Proceedings for the Next Board Meeting?

5. 3　Major Decisions

Inconsistent with most of the literature, the results say mainly the BOD is the body that makes major decisions of a company. According to DeMente, B. (2004); Learmount, S. (2002); Mizuo Junichi (2004); Monks, R. A. G (1994); Ohtsu Makoto and Imanari Tomio (2002) *jomu-kai* is the highest level decision making authority with limited number of managing directors. Conversely the results show that *jomu-kai* does not make any major decision in none of the companies of the sample, instead, as per the Table 11 and Figure 12, in 87% of the companies the BOD makes all such important decisions. Another interesting point is that only 3% of the company presidents' make such major decisions which affect the future direction of the company. Based on the past literature (Mizuo Junichi 2004) pin points that the *sacho* calls the shots on strategy, budget and nomination of other board members and officers. Probably this may be a recent development within the Japanese company with many other corporate reforms. The responses to the survey questionnaire seem to be an issue between '*honne*' and '*tatemae*'.

5. 3. 1　*Keiei iinkai* Instead of *Jomu-kai*

However, closer investigations using specific case studies brought clearer picture about making major decisions in Japanese companies. Some respondents revealed that their BOD really takes major decisions as a result of slimming down the board size. As another fact, several respondents presumed that BOD is the body which takes the decision since it is the place where the matter is finally approved. The in-depth investigations able to grasp that the major decisions are made at *keiei-iinkai* or *jomu-kai* and the duty of BOD is to ceremonially approve the decision. In many of the cases, now the trend is to have a top level meeting called *keiei-iinkai* replacing the earlier *jomu-kai*. One managing director revealed;

'In addition to board meeting as per the commercial law, we have keiei-iinkai which makes all the major decisions for future direction...'

Another director of a company having the traditional governance system explained;

'We did not change our familiar decision making system, because there is no need for such change. The decline in business is not purely due to a governance matter, it is mainly due to eco-

Table 11

Who makes major decisions mostly at your company?	No of Responded Companies	%
1. President	2	3%
2. Chairman	0	0%
3. BOD	55	87%
4. Managing director meeting of the board (Jomu Kai)	0	0%
5. Corporate officer meeting	1	2%
6. Others	5	8%
Total	63	100%

Source: Survey conducted by the author in 2004

nomic reasons... As our main market and the owners are in Japan we do not have any outside influence. So what we did was simply advance our familiar jomu-kai to keiei-iinkai for quick decision making.'

Some participants showed their policy document for establishing the *keiei-iinkai* and the major purpose of such formulation is to accelerate the important decision making and to allow on-the-spot decision making too. Major decision making in small and medium size companies have not been materially changed. However, they also have shifted to *keiei-iinkai* from *jomu kai* to enhance decision making. One president of a medium-size company told;

'We take all our important decisions at our newly formed keiei-iinkai. It is faster than our old jomu-kai, I feel. At the meeting I try to give hints and guidelines for other senior members for better decisions. Our (keiei-iinkai) final decision is communicated to the BOD meeting as information for other directors and for approval...'

While majority of interviewees revealed that *keiei-iinkai* or *jomu-kai* as the center for major decisions, they did not forget to declare that the CEO dominates the meeting as the leader of the company. However they feel that the level of influence is little bit lower than the past. One vice-president explained;

'we allow our CEO to run the meetings as our company head and decide the matters including appointment (BOD & next CEO), calling of meetings, determining goals, performance appraisal...but, now other directors also can contribute after appointing external directors to our board...'

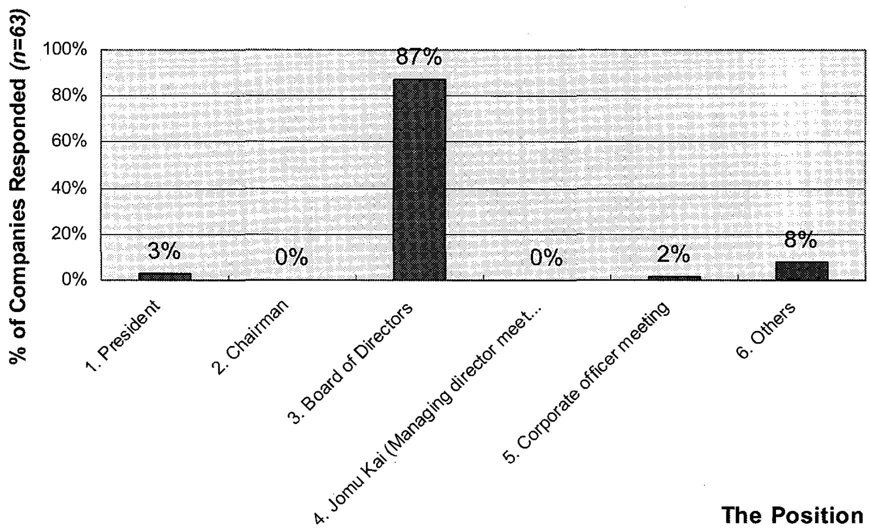
The level of dominating the meetings by the president of small and medium scale companies is comparatively high. But compared to the past they provide guidelines or hints rather than specific orders allowing other members to participate actively.

Respondents of the global companies having traditional governance system confirmed that they make their major decisions at *fuku-shacho kai* (vice-presidents' meeting) or special management committee which is in a higher position than the previous *jomu-kai*. Conversely the respondents of global companies having either committee system and intermediate system revealed that they make all their major decisions at the BOD meeting. This may be mainly due to the slimming down of their board size for efficient and effective decision making.

5. 3. 2 *Ringi* and *Nemawashi*

Use of *ringi* and *nemawashi* in Japanese companies varies according to companies and the levels of decision making. In many cases, *ringi* does not perform a key role in the top level decision making. A president of a medium scale company told;

"We use ringi with nemawaashi for important decisions at various sections. Bucho (general manager) is handling the ringi process. But for significant long-term decisions are not within the scope of ringi"



Source: Survey conducted by the author in 2004

Figure 12　Who Makes Major Decisions Mostly at Your Company?

Critical incidents found that mainly general manager's role is critical as he would write the proposal and would sell it to respective members mainly using *nemawashi* before the formal meeting. Thus the role of *ringi* is almost irrelevant as far as the ordinary employees are concerned. Conversely, the general manager's position is concerned *ringi* can be treated as a bottom-up decision making tool. *Nemawashi* is also helpful at this level, as a means of prior consultation or negotiation regarding the proposal. Another managing director added;

"Ringi was used earlier but not mainly at the top level decisions. As we have to take quick decisions we cannot wait for stamps of 30-40 people"

As a counter argument to the above, director of another company explained;

"We have introduced an electronic version of ringi. So it is very efficient. But for top level decisions the ringi's contribution is low."

Accordingly, still *ringi* and *nemawashi* are being used by Japanese companies with their advanced versions mainly in the middle level not in the top level. Major decisions are made using contingent approach or consultative and consensus decision making styles as explained by (Vroom, Victor, and Yettion, p. 1973).

5. 4　If a Long-term Goal cannot be Attained

As one of the important roles, the board as the top level of the entity must formulate the long-term goals and strategies for the implementation by the executive managers and finally monitor the evaluation. Specifically, in the role of evaluating, the board must pay attention to considerable deviations from the set goals. As specified in Table 12, none of the board members of responding firms takes responsibility for inability to attend the set long-term goals. Even though the major decisions are taken by the board or its own committee they do not take any responsibility and resign. At least the CEO as the figure head does not take any responsibility

Table 12

What does the company do if a long-term goal cannot be attained?	No of Responded Companies	%
1. The numerical values of the goal are amended	29	46%
2. The numerical values aren't amended until the end of a term.	17	27%
3. Members of the Board take responsibility, and resigns.	0	0%
4. A CEO (president or chairman) takes responsibility, and resigns.	0	0%
5. Others	17	27%
Total	63	100%

Source: Survey conducted by the author in 2004

for failure in achieving the set corporate goals. Instead, 46% of the companies (see Figure 13) just amend the numerical values of the goal before the end of the term and 27% of the companies just amend the numerical values at the end of the term.

The in-depth case studies were able to reveal that the treatments for the unattained goals are not as simple as shown above. In many instances the boards take considerable time to find out the treasons for the failures as a basis for remedial actions. One vice-president of a company having a traditional governance system put in plain words;
'We call a special board meeting after a keiei-iinkai and facilitate to discuss freely the reasons for the failure. We try to find out whether it is due a forecasting error, implementation problem, external impact like market failure, resource allocation problem etc. Accordingly we take remedial actions...for example if the matter is with forecasting we reforecast for the remaining period...'

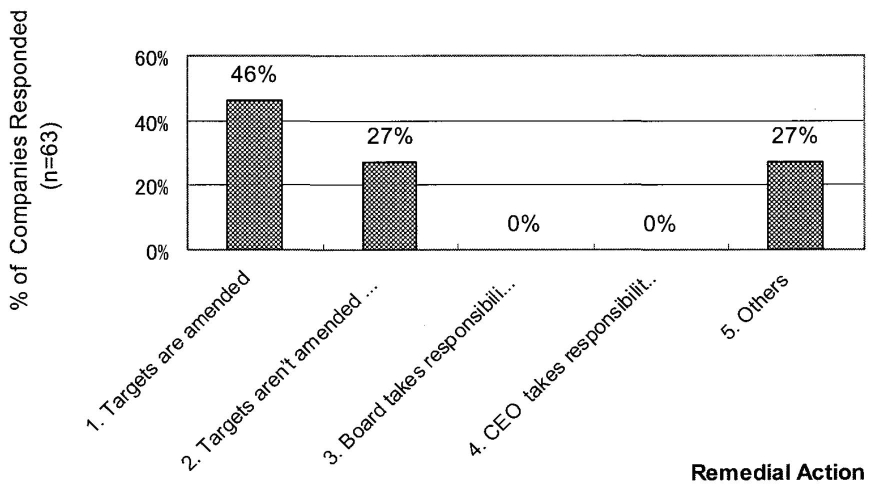
A director of a medium-sized company added;
'Not only our company most of Japanese companies don't allow for failures. We monitor the progress closely. If there are clues about a deviation we (top level) treat the reason. That is why Sony, Toyota, Matsushita.... are in the top positions...'

Some companies discuss the matter individually outside the BOD meeting as a true fact finding technique and slowly discuss the reasons for the failure and the corrective measures to be taken for immediate implementation. Another managing director of a company having an intermediate system made known;
'...though we (Japanese people) are slow decision makers, we discuss major deviations each other when and where we (senior directors) meet and consult with the relevant division/s before a formal board meeting (nemawasi). Then we deeply discuss the reasons for why the malfunction occurred and the strategies to be adopted as a foundation for quick implementation, instead of just taking responsibility or resigning...'

In global level companies, boards are more serious about such deviations and they take actions beyond the other companies mentioned. Depending on the degree of importance and the contents, they examine the countermeasures against the target achievements. If the failure is within the scope of execution, the actions of responsible executives are reviewed and if necessary training is provided. As disclosed by the respondents, any kind of major deviations are easily detected by their performance appraisal system. One company even tries to publish news release on their homepage if the failure is considerable as such issues are very sensitive for their investors, especially foreign investors. Most of these companies, they have corporate planning or long-term rolling planning system. If there is any deviation they try to identify the issue as early as possible using their monitoring function and thereafter the reasons and the probable actions are discussed in detail. Finally they direct the issue to the corporate planning committee or section for further improvements to the plan for better results.

In sum, disregarding the nature of governance system Japanese boards make every possible effort to grasp any failure through their monitoring function, instead of emphasizing on responsibility or resigning. One senior director generalized;
'In Japan we work as a group. Today's companies were brought to this level by both torishimariyaku in (directors) and kaisha in) (employees) by working hard together and harmony. If there is a failure every one is responsible, not only the yakuin (board members). If the yakuin resign it is another crisis and failure...'

Mainly the plans are reviewed and depending on the situation, if required they amend the targets. In most of the medium and small scale companies having traditional governance system the issue is firstly discuss within their senior element, *keiei-iinkai* or *jomu-kai* and then have a detail discussions at the BOD meeting with all the heads of divisions and bring the news to the employee level when necessary. In addition to above, global companies launch interrelated systems like corporate planning and performance appraisal regarding long-term goals.



Source: Survey conducted by the author in 2004

Figure 13　What Does the Company Do if a Long-Term Goal Cannot be Attained?

5. 5 Power to Decide the Next CEO

Succession planning for CEO is a vital matter for an entity as far as its continuing future is considered. Therefore each company must have a system to select its next CEO with reasonable care. In relation to Table 13, 56% of the companies' next CEO is decided by the BOD and 19% (see Figure 14) of the companies the authority is rest with the existing president. Earlier the general acceptance was that the present CEO has more power to decide the successor. This finding shows a substantial shift from the common generalization prevailed some time ago.

The existing CEO has considerable influence to decide the next CEO. Because in practice CEO nominates or appoints the members of the board and this surrounding creates a great obedience towards the CEO by other directors[10]. This enables the present CEO to select the most attractive/closer person for him as the next CEO. A director of a company with a traditional governance system added;

'...from the beginning the existing CEO appoints/nominates the next CEO to be, because he is the one who knows more about the next most appropriate person...'

In most of the medium and small companies, as usual in the past the next CEO is decided by the present CEO. At present, the participants believe that the selection of the future CEO is a challenging task as far the competition and the market stagnation are concerned. One senior managing director of a SMC explained;

'Our next CEO will be decided by our present president as usual. But now it has become a very difficult task to select the best one. Not like in the last 30-40 years the competition is severe within an unstable market...'

Compared to above in global level companies the situation is more complicated in addition to the domestic issues. In such companies, demands of foreign investors, nature of different legal, cultural and social matters in different markets, technological issues and global competition are some factors influencing the selection of next CEO. One leading company with a traditional

Table 13

Who has more power to decide the next CEO	No of Responded Companies	%
1. President	12	19%
2. Chairman	2	3%
3. BOD	35	56%
4. Not specially decided.	4	6%
5. Others	8	13%
Not Responded	2	3%
Total	63	100%

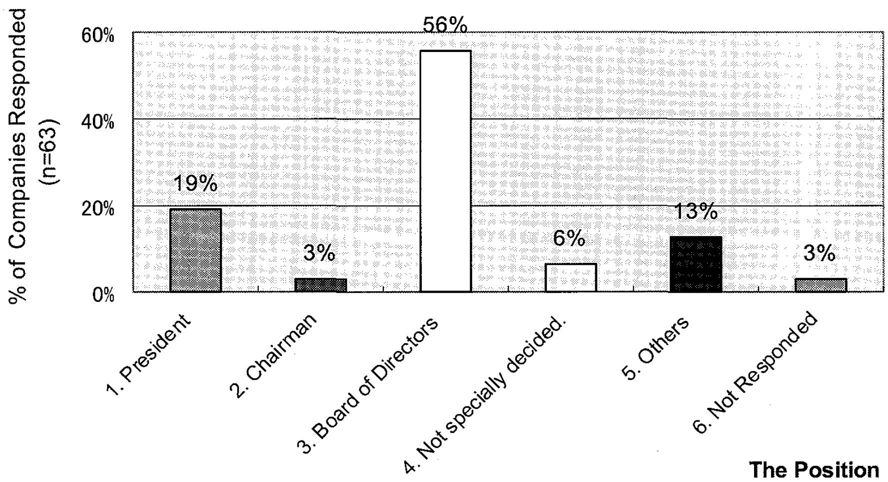
Source: Survey conducted by the author in 2004

10 see Vinner, A., (1993)

CG system mentioned that the appointment is not solely done by the president though he has the power to influence; the board decides the next CEO. Several other leading companies have already set up an advisory committee or appointment committee or personnel committee for deciding the next CEO. A director of a large company having an intermediate system carefully revealed;

'Of course, I think, present CEO has considerable sway. But with the acceleration of globalization, advisory committee has to nominate the best person capable of handling the voice of foreign investors, understanding different cultural, social and legal setups, technological matters, competition and so on. The successor should be able to win all these while winning the other members of the board. When there are non-Japanese in the board the impact is more critical...'

To go over the main points, there are many mechanisms to decide the next CEO in Japanese companies. On average, the existing president has a considerable capacity to decide the next CEO. However, in all the cases the magnitude of the influence is slightly sinking and majority of companies are assigning the task to the board or a committee of the board. More precisely, in medium or small scale companies mostly having traditional governance systems the selection or the pressure on selection is basically rest with the present CEO. However, even in such companies the successor is decided considering the ability to cope with the competition and market trends. In some global companies having traditional governance system, next CEO is decided by the BOD though there is a significant pressure from the existing president. Even this also evidences that the level of influence to select the next CEO solely not in the hand of the president; instead the power is being slowly shifted to the board. The leading companies having either intermediate or committee system have decided to shift the power of selecting the next CEO from president to a board committee; namely appointment committee or advisory committee or nomination committee to nominate and report it to the BOD meeting.



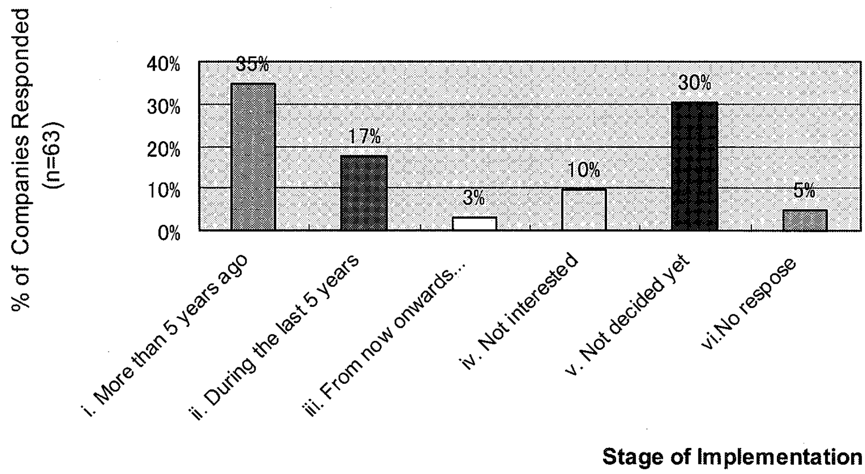
Source: Survey conducted by the author in 2004

Figure 14　Who has More Power to Decide the Next CEO?

Table 14

Outside Director System	No of Responded Companies	%
i . Already implemented more than 5 years ago	22	35%
ii . Already implemented during the last 5 years	11	17%
iii . From now onwards, it will be introduced.	2	3%
iv . Not interested	6	10%
v . Not decided yet	19	30%
vi . No response	3	5%
Total	63	100%

Source: Survey conducted by the author in 2004



Source: Survey conducted by the author in 2004

Figure 15 Implementation of Outside Director System

5. 6 Implementation of Outside Director System

As given in Table 14, 35% of respondents have already implemented outside directors more than 5 years ago. This 35% includes the outside directors introduced by the companies as a voluntary measure. Since there was no much research work available on this area, many were unaware of such a development before 5 years.

However, the rate has been increased remarkably by implementing another 17% of the companies (see Figure 15) during the last five years only. Though, only 3% whish to adopt the system now onward, 30% of the companies are uncertain about the adoption. However another 10% specifically decided not to implement such a feature within their traditional CG system.

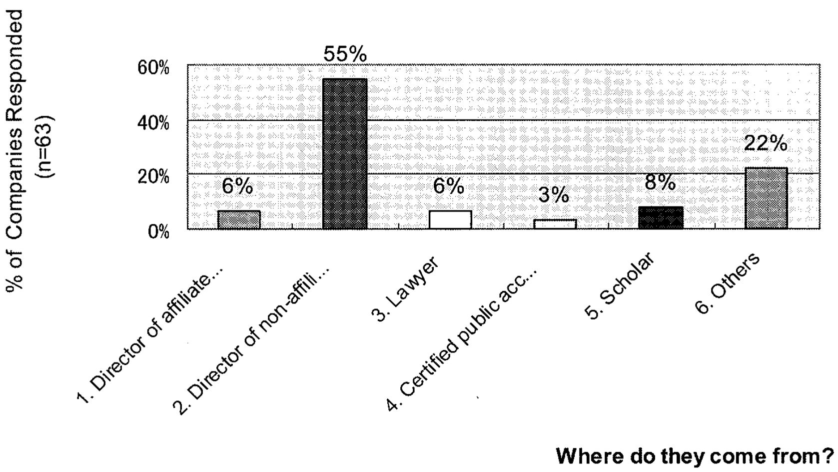
5. 6. 1 Who are the Outside Directors

In several years ago, almost all the outside directors are form affiliate companies as a tradition. Mainly this was due to the common belief that a total outsider has no comprehensive

Table 15

Who are the outside directors? (multiple answers accepted)	No of Observations	%
1. Directors of other companies (affiliate company)	4	6%
2. Directors of other companies (excluding affiliate company)	35	55%
3. Lawyer	4	6%
4. Certified public accountant	2	3%
5. Scholar	5	8%
6. Others	14	22%
Total	64	100%

Source: Survey conducted by the author in 2004



Source: Survey conducted by the author in 2004

Figure 16　Who are the Outside Directors?

understating about the company and its industry. Further, the outside director was just to represent either the main bank or parent company. By shifting away from the past situation, as given in Table 15 and Figure 16, 55% of the respondents expressed that their outside directors are from non-affiliate companies. Compared to the results of Policy Research Institute of Ministry of Economy and Financial Services in 2003, this is a remarkable improvement over one year even though the classification is different.

In the detail analysis, it was found that only few companies have included some client organizations, insurance companies and personally contacted companies in this category. Very specifically 6% of respondents who are comparatively small companies declared that they have outside directors from their affiliated companies. On the other hand, lawyers, certified public accountants and scholars are not very popular as outside directors among the respondents.

When deeply analyzing the medium and small scale companies with traditional CG system, they prefer a board free of outsiders or in some other cases they prefer outside directors from related or affiliate companies. Their main argument is that the outsiders have no deeper understanding about their company and industry like insiders who dedicated more than a half of their lives to the company. Thus, these companies sometimes simply reject outside directors mainly on the grounds of lack of awareness about the company, they hardly think about any input like innovative information flow from the external environment. This is mainly because of their ability to survive with the lower level of domestic competition. On the other hand, it is implied that they insist on this 'awareness matter', having an understanding that the outsider might take 'business decisions' instead of monitoring as there is no adequate separation between execution and monitoring in such companies. One CEO of a smaller company having a traditional governance system declared;

"Recently we introduced few outside directors from our related companies. If they are from unrelated areas, they cannot understand our necessities... (showing the gravity)"

Even though Japanese companies are not entirely new to the outside director system, in many cases they experienced only the outsiders from their group companies. Therefore, in one hand the independent directors are a new system which generates little uncertainty about the way of implementing. In fact they would like to adopt the system once they have a clear view about how a pure outsider can contribute effectively for another company having a little knowledge within this competitive business setup. Another managing director evidenced;

"In this turbulent business environment, every thorishimariyaku (BOD) is busy in their respective firms. Then, how do they effectively contribute for another completely different company with little awareness about our company? So we have one outside director. He is a son of an ex-director who had extensively contributed to develop the technical side of our company over many years".

Even if some companies are willing to adopt this system the 'independence status' has become a dilemma for them and they are questioning how a director of another company successfully add a value while serving for his respective company. A senior managing director who is eagerly waiting to see the soundness of implementing the outside director system in other companies added;

"We are not familiar with this kind of independent external directors. We are just observing the applicability. If it works well in other companies we also implement though it is difficult to find. Sony, ORIX and many others have implemented it. But, for me it is a puzzle that how the COE of ... (name of a global company) contribute in... (name of another global company) effectively with his busy schedule".

In several cases, the inability of finding independent directors was stressed mainly due to existing keiretsu and cross-shareholding systems. On the other hand they are very positive to think that there may be a considerable chance for Japanese companies in the near future for having such system since both keiretsu and cross-shareholding systems are in a declining trend.

"As you know in Japan we have keiretsu groups as well as cross-shareholding networks. Therefore most of the companies are interrelated. It is practically difficult to find so-called independent outside directors. Now with the reforms both the importance and steadiness of keiretsu and cross-shareholding have been falling. May be in 5-10 years we will be able to find such directors".

As an option to find outside directors, other than the popular way of appointing from related companies few companies have already chosen the directors from academic institutions. However, yet the intellectuals haven't effectively contributed in the boardroom. Most probably this may due to the initial stage of new experiment in the Japanese corporate setup. A director of a company having a traditional CG system explained about this new source to appoint outside directors;

"We have outside directors (from related companies). Now we are seeking for 1 or 2 independent directors form the academic sector. But a friend of mine told me that intellectuals' role was limited in their board room due to some practical reasons".

The system is very popular among larger global companies. As revealed through the detailed analysis they expected to absorb the news about emerging trends while ensuring independent monitoring over execution. More specifically, in global companies both institutional and individual investors are very much concerned on their investment and the board as the body of accountability, has to employee a closer monitoring system which can be easily understandable to those investors in a transparent manner. Furthermore, this kind of appointments is believed to be a basis for going for innovations to meet the global competition in order to gain a competitive advantage over the competitors. In several companies they are looking for a board having majority of outside directors with a chairman who is also an outside director. One director of larger company having US committee system positively declared about the prospects of the new system appreciating the reforms introduced through the amendments to the Commercial Law;

"We are seeking for new ideas from the external world while ensuring proper monitoring over execution. We hope to utilize every opportunity resulting from the amendments of commercial law."

In sum, about half of the companies have already implemented the outside director system even though some of them are not really independent. In several cases, especially in larger companies having shifted to US committee system, there are independent directors similar to their Western counterparts. Disregarding the size and the governance nature, there is a steady increase in introducing the system during the last five years. The small and medium size companies having a traditional CG system are little bit in a backward thinking though they are ready to implement the system if the pioneers get succeeded.

5. 7 Stock Options

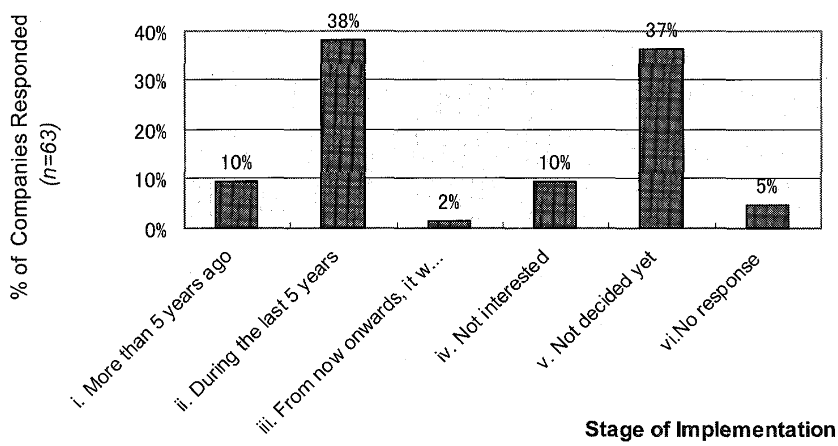
Stock options have been available and have been used as facets of management incentive plans for many years in many other countries. Recently stock options seem to be popular in Japan (see Figure 17) mainly as a compensation method for the top level. According to Table 16, five years ago only 10% of the respondents adopted stock options showing a very little interest on such remuneration system. Nevertheless during the last five years, in consistence with recent studies such as Policy Research Institute of Ministry of Economy and Financial Services in 2003, there is a jump (growth rate - 280%) in implementing stock options having a remarkable interest. Almost all the companies which implemented the system are very large companies. Medium and small companies are still reluctant to introduce it, may be mainly because of the lower popularity of their shares in the market.

Generally, the system in Japan is not matured like in most of the Western countries. Therefore, there may be instances where the system is inappropriately adopted by the directors and executives to influence their own compensation. Until the proper guidelines including per-

Table 16

Stock Options	No of Responded Companies	%
i . Already implemented more than 5 years ago	6	10%
ii . Already implemented during the last 5 years	24	38%
iii . From now onwards, it will be introduced.	1	2%
iv . Not interested	6	10%
v . Not decided yet	23	37%
vi . No response	3	5%
Total	63	100%

Source: Survey conducted by the author in 2004



Source: Survey conducted by the author in 2004

Figure 17 Implementation of Stock Option formance measures are established, rewarding for general market effects rather than superior performance will not be avoided.

5. 8 Evaluation of Board Performance

Another emerging trend of Japanese board is the performance evaluation of BOD (see Figure 18) which was never seen in most of the Japanese companies in the past. As presented in Table 17, 65% of companies revealed that they are having a mechanism for performance evaluation of BOD either individually or as a whole. The companies which do not adopt a performance appraisal system are mainly medium or smaller companies in the sample and not many global involvements.

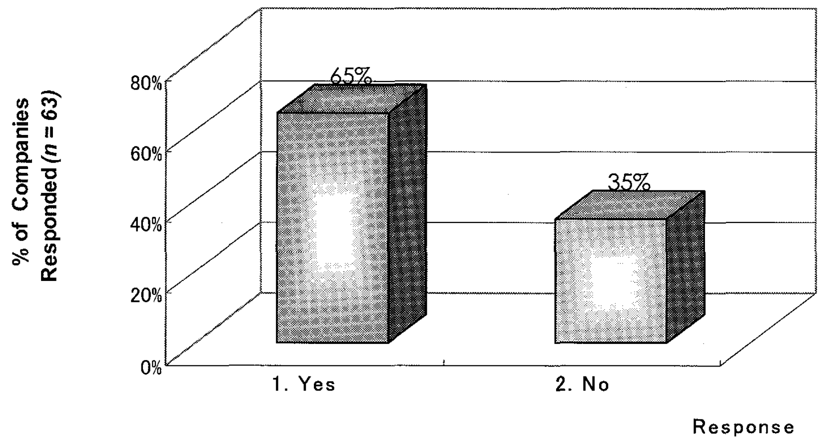
In the critical analysis, several larger corporations explained that the board is the center for future direction which should able to perform appropriately to win the competitive game over the global competitors. Hence the performance of the board and the members should be evaluated as a basis for further improvements. One managing Director expressed.
"Not like earlier, businesses are very competitive. As the drivers of the corporations, the board members' performance should be measured and try to improve them".

The performance appraisal criteria are kept confidential. Most of the companies conduct an

Table 17

Any Mechanism to Evaluate Performance of the Board (as a whole/individually)	No of Responded Companies	%
1. Yes	41	65%
2. No	22	35%
Total	63	100%

Source: Survey conducted by the author in 2004



Source: Survey conducted by the author in 2004

Figure 18　Is there any Mechanism to Evaluate Performance of the Board (as a whole/individually)

overall evaluation and they conduct a special meeting to discuss the performance. During the session they consider the level of achievement, major deviations and the major impact, reasons and performance improvement planning. In one company shifted to committee system revealed that the performance appraisal of BOD is an extensive process conducted by their compensation committee. On the other hand most of the medium and small companies the performance appraisal is done even though it is not a comprehensive exercise like in global companies. A managing director of medium size company revealed;
"We discuss about our performance at least once a year. As we have few directors, our president discusses each performance matter with each director. We exchange our experiences and suggestions to improve our performance."

In some companies, particularly smaller companies, there is no specific attempt to measure performance except the adhoc attempt by the CEO of some companies when there are problems with some products or sections.

5. 9 BOD's Impact on Corporate Governance

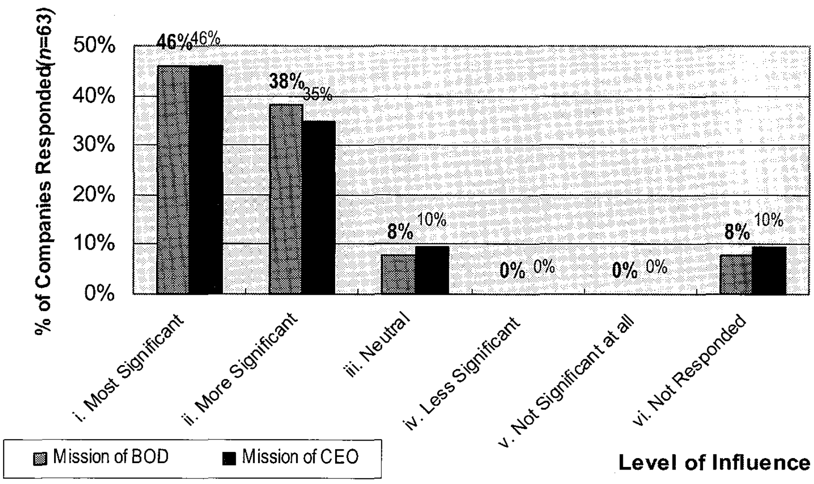
This study makes an effort to understand the validity of the preposition 'the heart of systems of corporate governance is the BOD' in Japanese context. Based on literature the impact of both BOD and CEO's mission and role on CG was examined. Interestingly, as shown in Table 18, having the same weight, 46% of the companies declared that both BOD and CEO's mission and role are very significant.

Further, over 81% of companies (see Figure 19) consider the BOD and CEO impact is at least more significant. Only about 10% of the respondents were neutral about the issue. The respondents who were neutral and not responded were comparatively smaller companies in the sample. The critical studies reiterate the above evidence. A senior managing director of a larger

Table 18

BOD's Impact on Corporate Governance	Mission of Board		Mission of CEO	
	No of Responded Companies	%	No of Responded Companies	%
i . Most Significant	29	46%	29	46%
ii . More Significant	24	38%	22	35%
iii . Neutral	5	8%	6	10%
iv . Less Significant	0	0%	0	0%
v . Not Significant at all	0	0%	0	0%
vi . Not Responded	5	8%	6	10%
Total	63	100%	63	100%

Source: Survey conducted by the author in 2004



Source: Survey conducted by the author in 2004

Figure 19　BOD's Impact on Corporate Governance

company having a traditional system elucidated;

"If we loose the contribution of board members and the CEO, the survival of our CG function is in danger".

Though the following phrase is extracted from a senior managing director of a small scale company, it divulged whatever the size or the existing CG system, the mission and role of BOD is significantly affect the smooth running of the CG.

"In total, CG system of our company means our BOD including the president. Apart from that no live CG function here."

The above finding indicates that no matter they have either traditional or US committee systems, the BOD and CEO of Japanese companies have an above average influence on their corporate governance systems. This is one of the key recent developments in the Japanese company with regard to CG. Furthermore, there is a good indication that both the monitoring and execution nail clippings are having a principle endeavor to enhance CG in real terms.

5. 10　Future Actions for a Stronger Board

During the last few years, majority of Japanese companies established many measures to enhance the boards. According to some studies including (Tokyo Stock Exchange 2000) the most popular actions were the reduction of the number of directors, introduction of executive directors, and appointment of external directors.

This study, having a forward look, attempts to find out the actions to be taken in the near future. As given in Table 19, 60% of the responses assured that the companies are willing to introduce a performance evaluation system for individual directors.

Table 19

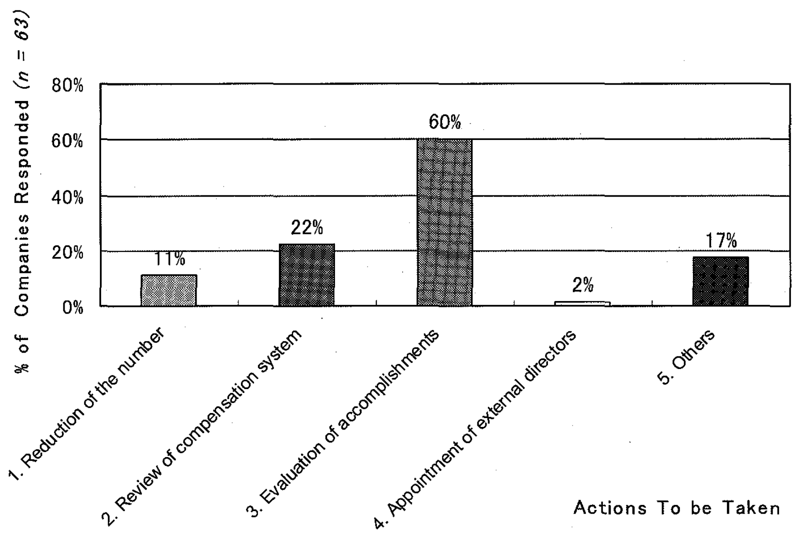
Future actions to be taken by the company for a stronger board (multiple answers accepted) (n=63) (Note: The TSE study emphasized on actions taken)	Present Study		TSE Survey in 2000
	No of Responses	%	No of Responses
1. The reduction of the number of directors	7	11	46.2
2. The review of directors' compensation system	14	22	16.7
3. The evaluation of accomplishing each director's performance	38	60	NA
4. The strengthening of the BOD from other companies	1	2	33.2
5. Others	11	17	27.9

Source: Survey conducted by the author in 2004

As discussed under 'evaluation of board performance' this trend is mainly due to the emphasis on efficiency and effectiveness considering the sky-scraping competition. The next most important action to be taken is the review of directors' compensation system as 22% of the respondents declared (see Figure 20). As found by the detailed investigations, 1 in 5 companies plan to shift their remuneration policy toward performance based system including board members. One managing director of a large company with a traditional governance system told;

"No longer can we continue 'seniority system' within this competitive setup? We take every measure to implement 'performance based system' for rewards even for board members."

All together, the increasing trend of reducing the number of directors in the board, introduction of executive directors, and appointment of external directors has been slower since those matters had been considered by most of the companies several years ago. That is why the re-



Source: Survey conducted by the author in 2004

Figure 20 Future Actions to be Taken for a Stronger Board sponse is low at the moment for such former actions as specified in Table 16. Proceed from that point forward; nowadays companies are more concern about very specific board reforms such as implementation of performance evaluation and review of remuneration. Most of the global companies having both traditional and US committee systems began to think on very specific future actions including; separation and strengthening of monitoring and execution, speed up of the decisions on routine operations and delegation of authority for enhancing their boards.

5. 11 Does the Japanese Board Ceremonial?

Thus far it has been generalized that the board meeting was principally a legal formality and a session for ratification for decisions taken somewhere else. The critical incidents grasped multifaceted views from various types of companies having different governance systems.

Majority of interviewees of SMCs which are basically having a traditional governance approach revealed that *jomu-kai* or *keiei-iinkai* is the center for major decisions as explained under the section 'major decisions. As a current tendency, number of firms decided to rename the *jomu-kai* as the *keiei-iinkai.* Through this they organize the meeting in a more efficient manner. Under this restructuring effort delegation of authority from the *jomu-kai* and BOD to the next lower levels, on-the-spot decision making, definition of matters to be handled by the top meetings and more emphasis on supervision has been considered. A president of a medium scale company acknowledged;
"In our newly formed keiei-iinkai we handle only very limited long-run matters only. Others are at the board meeting. Most of the routing decisions are referred to respective managers and the progress control is done at progress committee meeting."

Similarly, several interviewees enthusiastically conversed about several improvements inside the boardrooms. It means that even in medium or smaller companies, the top level reasonably understood the efficient decision making and monitoring rather than handling routine matters. Though the name has been converted to *keiei-iinkai* with some improved decision making ability compared to Western boards this *kai* is still much powerful than the BOD meeting. The above trend is not only within such smaller companies, even in larger companies having traditional governance approach also have under gone several improvements to enhance decision making. However, as stated under 'major decisions' they use a more powerful body for top level decisions above the BOD meeting like *fuku-shacho-kai.*

The most significant improvements are seen in the companies having either US committee system or intermediate system. Now major parts of decisions are carefully handled in respective committees allowing the BOD meeting to allocate more time for decisions relating to future direction of the company. At the same time *jomu-kai* or any other highest decision making bodies above the board have been vanished establishing the real board as the ultimate

decision making authority. One director representing this category mentioned;
"Now our corporate decision making structure is crystal clear. Our board members are really enjoying a pleasant surrounding to dream about the future of our company and to monitor the execution."

In addition to the above general trend, in some instances board meeting is still a legal formality though it contained improved features. However, average time is 2-3 hours; a considerable extension of time usage for discussions. A managing director of a larger company with a traditional CG system revealed;

"We hold the BODs meeting once a month. (...suddenly emphasizing the legal requirement) Major issues require more meetings in addition to legal conformity. We discuss the issues about 3 hours leisurely in order to communicate appropriately until a proper ratification"

In couple of companies it is a meeting for heads of divisions to report the operational matters and to acknowledge the entire entity. Hence it is a representative meeting of the entire company with large number of members. A director of a large manufacturing firm viewed the BOD meeting as a session of communicating the progress;

'Every month we (all heads of divisions) report the progress to the board regarding the performance of previous month. It is a place for us to review the recent history and to determine the near future.'

Furthermore, board members of several companies have not yet gave-up their habitual decision making in the business divisions. Another director rationalized his involvement in operational decisions as follows.

'Though we are on the side of monitoring, as elders of the company it is our duty to interfere operational decisions with our experience as possible as we can. If not we can not survive with competition. This is the nature of Japanese governance...'

Taken as a whole, the 'ceremonial nature' of Japanese Corporate Board has slightly been shifting away and emphasizing more on efficient and effective decision making. In many incidents *jomu-kai* has replaced by *keiei-iinkai* with some improved features. Most popular developments in top level decision making are the on-the-spot direct decision making, directing only the sorted essentials to *keiei-iinkai* and the board, discussing the essential matters in detail and redirecting the proposals to the committees and concerning more on monitoring. Newly restructured companies with either US committee system or intermediate system have already moved away from the ceremonial board for better top level decisions and monitoring. In contrast, several leading companies having traditional governance system do not allow for any injection to formulate or revise decisions made by *fuku-shacho kai* or similar meeting even having more power than the *jomu-kai*. Then the BOD meeting of such companies have nothing other than the ratification of the decisions taken somewhere else. Further, in some incidents companies having traditional approach still conduct the board meeting as a legal formality or a session for progress control & operational decisions and some directors are still engaged in operational decisions at lower divisions.

6. Summary and Conclusions

In consequence of globalization and information technology Japanese socio-economic system began to change gradually but continually. As far as the Japanese corporate governance system is concerned there have been dramatic changes resulted from the revisions to the Commercial Law and Japanese Financial System since 1996. The impact of these alterations has began to make a great revolution inside the Japanese board rooms by introducing some of the new features to their existing governance system such as outside director system, executive officer system, stock options, performance evaluation system, slimming down the boards, disclosures about boards etc. The most significant change is that the shifting of more than 40 larger companies to the US committee system recently.

This study found the changing nature of Japanese corporate boards using a comprehensive methodology having both questionnaire survey and several critical incidents based on Chell (1993). According to the study there are several CG models across the firms. Therefore the results were discussed under four main test categories namely SMCs having traditional governance system, larger companies having intermediate system, larger companies having traditional governance system and larger companies having US committee system.

Leader of the BOD meeting is basically the president as an inherent feature of governance in the Japanese company, especially having a traditional approach to CG. Conversely, the companies which shifted US committee system do not seem to be adhered to such traditional orientation; instead they pursue the rules and norms which followed by the system. Therefore the leader of the BOD' meeting is mainly an outside director like in the US.

A large number of the companies have already started to circulate a formal set of proceedings with a notice at least a week before the next board meeting even in several SMCs. However there are still some companies that do not distribute the documents allowing a specific time period before the meeting. Newly restructured companies toward US committee system or intermediate system attempt to provide a comprehensive set of materials at least one week before the meeting.

The *keiei-iinkai* or *jomu-kai* is still the center for major decisions in SMCs, however now the degree of dominance by the president is low. Major decisions of global companies having traditional governance system are taken at *fuku-shacho kai* (vice-presidents' meeting) or special management committee which is in a higher position than the previous *jomu-kai*. On the contrary the major decisions of global companies having either committee system or intermediate system are taken at the BOD meeting. Still *ringi* and *nemawashi* are being used by Japanese companies with their advanced electronic versions mainly in the middle level not in the top level. Major decisions are made using contingent approach or consultative and consensus decision making styles as explained by (Vroom, Victor, and Yettion, p. 1973).

When attaining a long-term goal is in a doubt, disregarding the nature of governance system, Japanese boards make every possible effort to grasp any failure through their monitoring function, instead of emphasizing on responsibility or resigning. Mainly the targets are reviewed and if necessary they are amend. In most of the SMCs having traditional governance system the issue is firstly discuss within their *keiei-iinkai* or *jomu-kai* and then have detail discussions at the BOD meeting with all the head of divisions and bring the news to the employee level when necessary. The global companies launch interrelated systems like corporate planning and performance appraisal regarding long-term goals.

There are many mechanisms to decide the next president in Japanese companies. On average, within the traditional governance setup the existing president has a considerable power to decide the next president. Nevertheless, in all the cases the magnitude of the level of influence is slightly sinking and majority of companies are assigning the task to the BOD or a committee of the BOD. In particular, in SMCs mostly having traditional governance systems, the selection or the pressure on selection is basically rest with the existing president. However, now, even in such companies the successor is decided based on the ability to cope up with the competitive market conditions. In some global companies having traditional governance system, next president is decided by the BOD though there is a significant pressure from the existing president. Even this also evidences that the level of influence to select the next president solely not in the hand of the existing president; instead the power is being slowly shifted to the board. The leading companies having either intermediate or committee system shifted the power of selecting the next president from president to a board committee; namely the nomination committee to nominate and report it to the BOD meeting.

Generally, about half of the companies have already implemented the outside directors though some of them are not independent in actual terms. Particularly in larger companies having shifted to US committee system, there are independent directors similar to their Western counterparts. Disregarding the size and the governance nature, there is a steady increase in introducing the system during the last five years. The SMCs having a traditional CG system are in a doubt though they are willing to implement the system until the pioneers get succeeded.

The stock options in Japan are not matured like in most of the western countries. Therefore, there may be instances where the system is inappropriately adopted by the directors and executives to influence their own compensation. Unless the proper guidelines including performance measures are established, rewarding for general market effects rather than superior performance can not be avoided.

On average, in evaluating the performance of BOD, companies consider the level of achievement, major deviations and the major impact, reasons and performance improvement planning. In larger companies shifted to US committee system the performance appraisal of BOD is an extensive process conducted by their compensation committee. On the other hand most of the SMCs, the performance appraisal is done even though it is not a comprehensive exercise like in global companies.

The finding indicates that no matter the system is traditional or US committee, the BOD and president of Japanese companies have an above average influence on their corporate governance systems. This is one of the recently being emerged developments in the Japanese company with regard to CG. Moreover, there is a good indication that both the monitoring and execution ends are very keen in enhancing CG further in a true sense.

The increasing trend of slimming down the board, introduction of executive directors, and appointment of external directors has been slower since those matters had been considered by most of the companies few years ago. That is why the response is low at the moment for such former actions as specified above. At present the companies are more concern about very specific board reforms such as implementation of performance evaluation and review of compensation. Nearly every one of the global companies having both traditional and US committee systems have already decided on specific future actions including; separation and strengthening of monitoring and execution, speed up of the decisions on routine operations and delegation of authority for enhancing their boards.

The 'ceremonial nature' of Japanese Corporate Board has been shifting away to some extent and emphasizing more on efficient and effective decision making. In many cases *jomu-kai* has replaced by *keiei-iinkai* with some improved features. The companies shifted either to US committee system or to intermediate system have already moved away from the ceremonial board for better top level decisions and monitoring. In contrast, several leading companies having traditional governance system do not allow for any injection to formulate or revise decisions made by *fuku-shacho kai* or similar meeting having more power than the *jomu-kai*. Then the BOD meeting has nothing apart from the ratification of the decisions taken elsewhere. Further, in some incidents companies having traditional approach still conduct the board meeting as a legal formality or a session for progress control & operational decisions and some directors are still engaged in operational decisions of the divisions.

Derived from the above facts, there are numerous patterns of corporate governance have been emerging in Japan as a result of the stimulations granted by the revisions to the Commercial Law. The nature and the role of BODs of companies shifted to US committee system and intermediate system have been significantly changed. Now, in those companies there is a considerable segregation between monitoring and execution indicating a tendency to converge towards the Anglo-Saxon model. However, there are some global companies highly resist adopting such new governance system instead they further improve their system according to the local and global requirements. The SMCs still prefer the traditional model which benefits them over a half a century. Anyhow, SMCs have taken several steps to improve their traditional system for better governance in their respective companies.

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